

Annual Corporate Governance Report for Listed Companies

A. Ownership structure

A.1 Complete the following table on the company's share capital:

Date of last modification	Share capital (€)	Number of shares	Number of voting rights
2016/12/07	5,037,804,990.00	5,037,804,990	5,037,804,990

Indicate whether different types of shares exist with different associated rights:

No

A.2 List the direct and indirect holders of significant ownership interests in your company at year-end, excluding directors:

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	318,861,940	0	6.33%
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	0	259,651,258	5.15%
Blackrock, Inc.	0	262,747,410	5.22%

Name or corporate name of indirect holder	Through: Name or corporate name of direct holder	Number of voting rights
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Vidacaixa, S.A. de Seguros y Reaseguros	189,470
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Caixabank, S.A.	259,461,788
Blackrock, Inc	Blackrock Group	262,747,410

DISCLAIMER: The English version is a translation of the original in Spanish for information purposes only. In the event of discrepancy, the Spanish original will prevail.

Indicate the most significant movements in the shareholding structure during the year.

Name or corporate name of shareholder	Date of transaction	Description of transaction
Blackrock, Inc	2016/09/14	Exceeded 5% of the share capital

A.3 Complete the following tables on company directors holding voting rights through company shares.

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Mr. José María Álvarez-Pallete López	1,230,745	0	0.02%
Mr. Isidro Fainé Casas	595,382	0	0.01%
Mr. José María Abril Pérez	157,077	158,211	0.01%
Mr. Julio Linares López	480,889	8,440	0.01%
Mr. César Alierta Izuel	5,505,144	0	0.11%
Ms. Eva Castillo Sanz	113,594	0	0.00%
Mr. José Javier Echenique Landiribar	31,850	75,712	0.00%
Mr. Peter Erskine	42,733	0	0.00%
Mr. Luiz Fernando Furlán	38,423	0	0.00%
Mr. Gonzalo Hinojosa Fernández de Angulo	51,135	206,815	0.01%
Mr. Pablo Isla Álvarez de Tejera	10,294	0	0.00%
Mr. Antonio Massanell Lavilla	2,743	0	0.00%
Mr. Ignacio Moreno Martínez	18,311	0	0.00%
Mr. Francisco Javier de Paz Mancho	64,862	0	0.00%

Name or corporate name of indirect shareholder	Through: Name or corporate name of direct shareholder	Number of voting rights
Mr. José María Abril Pérez	Other company shareholders	158,211
Mr. Julio Linares López	Other company shareholders	8,440
Mr. José Javier Echenique Landiribar	Other company shareholders	75,712
Mr. Gonzalo Hinojosa Fernández de Angulo	Other company shareholders	206,815
% of total voting rights held by the Board of Directors		0.17%

Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	Equivalent number of shares	% of total voting rights
Mr. José María Álvarez-Pallete López	384,000	0	600,000	0.01%
Mr. César Alierta Izuel	648,000	0	1,012,500	0.01%

A.4 Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are of little relevance or arise from ordinary trading or exchange activities.

A.5 Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are of little relevance or arise from ordinary trading or exchange activities.

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Banco Bilbao Vizcaya Argentaria, S.A. (or any of the companies of its Group), together with Telefónica, S.A. and with Caixabank, S.A., in Telefónica Factoring España, S.A., Telefónica Factoring Perú, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Ciérvana, S.L. (a company which belongs to Grupo BBVA), together with Telefónica Compras Electrónicas, S.A.U., in Adquiria España, S.A.
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Corporate	Shareholding of Caixabank, S.A., with Telefónica, S.A. and with Banco Bilbao Vizcaya Argentaria, S.A. (or with any of the companies of its Group), in Telefónica Factoring España, S.A., Telefónica Factoring Perú, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Corporate	Shareholding of Caixabank consumer Finance, E.F.C., S.A. (subsidiary of Caixabank, S.A.) together with Telefónica, S.A., in Telefónica Consumer Finance, E.F.C., S.A.

A.6 Indicate whether any shareholders' agreements have been notified to the company pursuant to Articles 530 and 531 of the Spanish Corporations Act (Ley de Sociedades de Capital, hereinafter "LSC" in Spanish). Provide a brief description and list the shareholders bound by the agreement, as applicable.

Yes

Parties to the shareholders' agreement	
Vivendi, S.A.	
Telefónica, S.A.	
% of share capital affected	
	0.98%

Brief description of the agreement:

See heading H "Other information of interest", Note 5 to Section A.6.

Parties to the shareholders' agreement	
Telefónica, S.A.	
China Unicom (Hong Kong) Limited	
% of share capital affected	
	1.27%

Brief description of the agreement:

See heading H "Other information of interest", Note 5 to Section A.6.

Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable.

No

Expressly indicate any amendments to or termination of such agreements or concerted actions during the year.

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A.7 Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with Article 5 of the Spanish Securities' Market Act (Ley del Mercado de Valores). If so, identify.

No

A.8 Complete the following tables on the company's treasury shares.

At year end:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
141,229,134	0	2.80%

(*) Through:

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Detail any significant changes during the year, in accordance with Royal Decree 1362/2007.

Explain any significant changes

On January 15, 2016, Telefónica notified the Spanish National Securities Market Commission, (Comisión Nacional del Mercado de Valores, CNMV), the direct acquisition of 53,265,917 shares, which represented 1.071% of the company's share capital.

In accordance with the resolution for reduction in share capital through the cancellation of treasury shares approved by the Ordinary General Shareholders Meeting on May 12, 2016, and after the resolution to that effect adopted by the Board of Directors of the Company, the deed of the share capital reduction was registered in the Companies Registry of Madrid on October 11, 2016. Consequently, 74,627,988 treasury shares of Telefónica, S.A., which represented 1.50% of its share capital, were cancelled.

On October 18, 2016, Telefónica notified the Spanish National Securities Market Commission, (Comisión Nacional del Mercado de Valores, CNMV), the direct acquisition of 49,405,408 shares, which represented 1.008% of the company's share capital.

On December 9, 2016, Telefónica notified the Spanish National Securities Market Commission, (Comisión Nacional del Mercado de Valores, CNMV), the acquisition of 5,431,889 shares, which represented 0.108% of the company's share capital, as consequence of the execution of the share capital increase approved by the Ordinary General Shareholders Meeting of Telefónica, S.A. on May 12, 2016, under the item VIII.2 of its Agenda.

A.9 Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting authorizing the Board of Directors to repurchase or transfer the treasury shares.

At Telefónica's Ordinary General Shareholders Meeting held on May 30, 2014, the shareholders resolved to renew the authorisation granted at the General Shareholders Meeting of June 2, 2010, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

"A) Authorise, pursuant to articles 144 and the articles thereunder of the Spanish Corporations Act, the derivative acquisition, at any point and as many times as it might be deemed necessary, by Telefónica, S.A. –either directly, or through any of its subsidiaries – of treasury stock, fully-paid, by purchase and sale, by exchange or by any other legal transaction.

The minimum acquisition price or minimum value of the consideration shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or maximum consideration value shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders' Meeting and is expressly subject to the limitation that the par value of the Company's own shares acquired directly or indirectly pursuant to this authorization added to those already held by Telefónica, S.A. and all its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company's own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights owned by them, all within the framework of duly approved compensation systems referencing the listing price of the Company's shares.

B) To authorize the Board of Directors, as broadly as possible, to exercise the authorisation granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

C) To deprive of effect, to the extent of the unused amount, the authorization granted under Item III on the Agenda by the Ordinary General Shareholders Meeting of the Company on June 2, 2010."

A.9.bis. Estimated free-float capital:

Estimated free-float capital	%
	78.08

A.10 Indicate, as applicable, any restrictions on the transfer of securities and/or any restrictions on voting rights. In particular, indicate any type of restrictions that could impose obstacles to the takeover of the company by means of share purchases on the market.

Yes

Description of the restrictions

See heading H "Other information of interest", Note 7 to Section A.10.

A.11 Indicate whether the General Shareholders' Meeting has agreed to take neutralisation measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.

No

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted.

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A.12 Indicate whether the company has issued securities not traded in a regulated market of the European Union.

Yes

If so, identify the various classes of shares and, for each class of shares, the rights and obligations they confer.

Shares of Telefónica, S.A. are traded on the Spanish electronic trading system (the "Continuous Markets"), and also on the stock exchanges of New York, London, Lima and Buenos Aires, and they all have the same characteristics, rights and obligations.

On the New York and Lima stock exchanges, Telefónica, S.A. shares are traded through American Depositary Shares (ADSs), where each ADS represents a Company share.

B. General Shareholders Meeting

B.1 Indicate and, as applicable, describe any difference between the system of minimum quorums for constitution of the General Shareholders Meeting established in the Spanish Corporations Act (Ley de Sociedades de Capital, hereinafter "LSC" in Spanish).

No

B.2 Indicate and, as applicable, describe any differences between the company's system of adopting corporate resolutions and the framework established in the LSC:

No

Describe how they differ from the rules established in the LSC.

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B.3 Indicate the rules governing amendments to the company's Bylaws. In particular, indicate the majorities required to amend the Bylaws and, if applicable, the rules for protecting shareholders' rights when changing the Bylaws.

The Bylaws and Regulations for the General Shareholders Meeting of Telefónica confer upon the General Shareholders Meeting the power to agree to amend the Corporate By-laws (articles 15 and 5, respectively), being subject to legal provisions applicable for all other matters.

The procedure for amending the Bylaws is governed by Articles 285 and following articles of the revised text of the Spanish Corporations Act, and needs to be approved at the General Shareholders Meeting with the majorities stated in Articles 194 and 201 of the same law. In particular, if the Shareholders Meeting is convened to deliberate on Bylaw amendments, including capital increases or decreases, on eliminating or restricting the preferential acquisition right for new shares, and the transformation, merger, spin-off, or the global assignment of assets and liabilities and the relocation of the registered offices abroad, then shareholders which own at least fifty per cent of the subscribed capital with voting rights will have to be present or be represented by proxy on first call. If there is no sufficient quorum, then the Shareholders' Meeting will be held on second call, on this occasion at least twenty-five per cent of the subscribed capital with voting rights will need to be present, either in person or by proxy. When shareholders which represent less than fifty per cent of the subscribed capital with voting rights are present at the Shareholders Meeting, either in person or by proxy, the resolutions referred to above can only be approved when two thirds of the capital, present or represented by proxy at the Shareholders Meeting, vote in favour of the resolution.

Pursuant to article 286 of the Spanish Corporations Act, if the Bylaws are amended, then the Directors, or, if applicable, the shareholders who have made the proposal, will have to draw up in full the text of their proposed amendment, and a written report in which they justify the amendment, which will have to be submitted to the shareholders which are taking part in the Shareholders' Meeting to deliberate on that amendment.

Furthermore, pursuant to article 287 of the Spanish Corporations Act, the announcement calling the General Shareholders Meeting will have to clearly state the questions which might have to be amended, and note that all the shareholders are entitled to analyse the full text of the proposed amendment and the report on such an amendment at the registered offices, and also to request that such documents be delivered to them or sent free of charge.

According to article 291 of the Spanish Corporations Act, when new obligations are established for shareholders due to amendment of the Bylaws, the resolution will have to be passed with the approval of the affected shareholders. Furthermore, if the amendment directly or indirectly affects a type of shares, or part of them, then the provisions of article 293 of that Act will be applicable.

The procedure for voting on proposed resolutions by the Shareholders' Meeting is also regulated in Article 197 bis of the Spanish Corporations Act, in the internal regulations of Telefónica (in particular, in Article 23 of the Regulations of the General Shareholders Meeting). This Article states that, when amendments are made to the Bylaws, each article or group of articles which are materially different will be voted for separately.

B.4 Indicate the attendance figures for the General Shareholders' Meetings held during the year:

Date of general meeting	Attendance data					Total
	% attending in person	% by proxy	% remote voting			
			Electronic means	Other		
2015/06/12	11.55%	46.36%	0.01%	0.48%	58.40%	
2016/05/12	0.21%	55.34%	0.03%	0.55%	56.13%	

B.5 Indicate whether the Bylaws impose any minimum requirement on the number of shares required to attend the General Shareholders Meetings.

Yes

Number of shares required to attend the General Shareholders Meetings
300

B.6 Section eliminated.

B.7 Indicate the address and mode of accessing corporate governance content on your company's website as well as other information on General Meetings which must be made available to shareholders on the website.

Telefónica complies with applicable legislation and best practices in terms of the content of its website concerning Corporate Governance. In this respect, it fulfils both the technical requirements for access and for content for the Company website, including information on General Shareholders Meetings, through direct access from the homepage of Telefónica, S.A. (www.telefonica.com) in the section "Shareholders and Investors" (www.telefonica.com/accionistaseinversores), which includes not only all of the information that is legally required, but also information that the Company considers to be of interest.

All the available information included on the Company website, except for certain specific documents, is available in two languages: Spanish and English.

C. Company management structure

C.1 Board of Directors

C.1.1 List the maximum and minimum number of directors included in the Bylaws:

Maximum number of directors	20
Minimum number of directors	5

C.1.2 Complete the following table with board members' details.

Name or corporate name of director	Representative	Type of director	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. José María Álvarez-Pallete López	-	Executive	Chairman	2006/07/26	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Isidro Fainé Casas	-	Proprietary	Vice Chairman	1994/01/26	2016/05/12	Resolution of General Shareholders' Meeting
Mr. José María Abril Pérez	-	Proprietary	Vice Chairman	2007/07/25	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Julio Linares López	-	Other external directors	Vice Chairman	2005/12/21	2016/05/12	Resolution of General Shareholders' Meeting
Mr. César Alierta Izuel	-	Other external directors	Director	1997/01/29	2012/05/14	Resolution of General Shareholders' Meeting
Ms. Eva Castillo Sanz	-	Other external directors	Director	2008/01/23	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Juan Ignacio Cirac Sasturain	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. José Javier Echenique Landiribar	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. Peter Erskine	-	Independent	Director	2006/01/25	2016/05/12	Resolution of General Shareholders' Meeting
Ms. Sabina Fluxà Thienemann	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. Luiz Fernando Furlán	-	Independent	Director	2008/01/23	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo	-	Independent	Director	2002/04/12	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Pablo Isla Álvarez de Tejera	-	Independent	Director	2002/04/12	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Peter Löscher	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. Antonio Massanell Lavilla	-	Proprietary	Director	1995/04/21	2016/05/12	Resolution of General Shareholders' Meeting

Mr. Ignacio Moreno Martínez	-	Proprietary	Director	2011/12/14	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Francisco Javier de Paz Mancho	-	Independent	Director	2007/12/19	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Wang Xiaochu	-	Proprietary	Director	2015/09/30	2016/05/12	Resolution of General Shareholders' Meeting

Total number of directors

18

Indicate any board members who left during this period.

Name or corporate name of director	Type of directorship at time of leaving	Leaving date
Mr. José Fernando de Almansa Moreno-Barreda	Other external Directors	2016/04/08
Mr. Carlos Colomer Casellas	Independent	2016/04/08
Mr. Santiago Fernández Valbuena	Executive	2016/04/08
Mr. Alfonso Ferrari Herrero	Independent	2016/04/08

C.1.3 Complete the following tables on board members and their respective categories:

EXECUTIVE DIRECTORS

Name or corporate name of director	Post held in the company
Mr. José María Álvarez-Pallete López	Executive Chairman
Total number of executive directors	1
% of the Board	5.56%

EXTERNAL PROPRIETARY DIRECTORS

Name or corporate name of director	Name or corporate name of significant shareholder represented or proposing appointment
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Isidro Fainé Casas	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"
Mr. Antonio Massanell Lavilla	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"
Mr. Wang Xiaochu	China Unicom (Hong Kong) Limited
Total number of proprietary directors	5
% of the Board	27.78%

INDEPENDENT EXTERNAL DIRECTORS

Name or corporate name of director	Profile
Mr. Francisco Javier de Paz Mancho	Graduate in Information and Advertising. Law Studies. IESE Business Management Program. Formerly Chairman of the State-owned company MERCASA.
Mr. Gonzalo Hinojosa Fernández de Angulo	Industrial Engineer. Formerly Chairman and CEO of Cortefiel Group.
Mr. Pablo Isla Álvarez de Tejera	Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A.

Mr. Peter Erskine	Psychology Graduate. Was General manager of Telefónica Europe until 2007. Was Chairman of Ladbrokes, Plc until December 2015.
Mr. Luiz Fernando Furlán	Degrees in chemical engineering and business administration, specialising in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.
Ms. Sabina Fluxà Thienemann	Business Management and Administration graduate. MBA from ESADE. High Business Management Program at IESE. Co-Vice Executive President and CEO of Iberostar Group.
Mr. José Javier Echenique Landiribar	Economic and Actuarial Sciences graduate. Vice-Chairman of Banco Sabadell, S.A. Degree in Economics and Business. MBA at Vienna University of Economics. Advanced Management Program at Harvard Business School. Chairman of the Supervisory Board of OMV Aktiengesellschaft and Sulzer AG.
Mr. Peter Löscher	Graduated in Theoretical Physics. Ph. D. in Physics. Fields of Specialization in Theoretical Quantum Optics, Quantum Information, Atomic Physics, Quantum Many-Body Physics.
Mr. Juan Ignacio Cirac Sasurain	
Total number of independent directors	9
% of the Board	50.00%

List any independent directors who receive from the company or group any amount or payment other than standard director remuneration or who maintain or have maintained during the period in question a business relationship with the company or any group company, either in their own name or as a significant shareholder, director or senior manager of an entity which maintains or has maintained the said relationship.

No

If applicable, include a statement from the board detailing the reasons why the said director may carry on their duties as an independent director.

OTHER EXTERNAL DIRECTORS

Identify the other external directors and list the reasons why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders.

Name or corporate name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained
Mr. Julio Linares López	On September 17, 2012, Mr. Julio Linares López resigned from his post as Chief Operating Officer (C.O.O.) of Telefónica, S.A. and his managerial post in the Telefónica Group, and therefore went from being an Executive Director to being classified in the "Other External Directors" category.	Telefónica, S.A.
Ms. Eva Castillo Sanz	On February 26, 2014, Ms. Eva Castillo Sanz resigned as Chairwoman of Telefónica Europa, and was therefore included in the "Other external Directors" category.	Telefónica, S.A.
Mr. César Alierta Izuel	On April 8, 2016, Mr. César Alierta Izuel resigned from his post as Executive Chairman of Telefónica, S.A. and his executive duties in the Telefónica Group, and therefore went from being an Executive Director to being classified in the "Other External Directors" category.	Telefónica, S.A.
Total number of other external directors		3
% of the Board		16.67%

List any changes in the category of each director which have occurred during the year.

Name or corporate name of director	Date of change	Former category	Current category
Mr. César Alierta Izuel	2016/04/08	Executive	Other External

C.1.4 Complete the following table on the number of female directors over the past four years and their category.

	Number of female directors				% of total directors of each type			
	Year 2016	Year 2015	Year 2014	Year 2013	Year 2016	Year 2015	Year 2014	Year 2013
Executive	0	0	0	1	0.00%	0.00%	0.00%	25.00%
Proprietary	0	0	0	0	0.00%	0.00%	0.00%	0.00%
Independent	1	0	0	0	11.11%	0.00%	0.00%	0.00%
Other External	1	1	1	0	33.33%	33.33%	50.00%	0.00%
Total:	2	1	1	1	11.11%	5.56%	5.56%	5.56%

C.1.5 Explain the measures, if applicable, which have been adopted to ensure that there is a sufficient number of female directors on the board to guarantee an even balance between men and women.

Explanation of measures

The search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to co-opt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. Eva Castillo Sanz as a Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders Meeting held on April 22, 2008, and she was re-elected to serve in this position by the Ordinary General Shareholders' Meeting on May 31, 2013.

Likewise, on April 8, 2016, the Board of Directors unanimously agreed to co-opt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. Sabina Fluxà Thienemann as a Director of Telefónica. The Ordinary General Shareholders Meeting, held on May 12, 2016, ratified this appointment.

Similarly, on December 19, 2007, the Board of Directors unanimously agreed, following a recommendation from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary to the Board of Directors.

Article 10.3. of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognised calibre, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

Article 10.4 of the Regulations of the Board of Directors also provides that the Board will have to ensure that Board members are selected using procedures that guarantee gender equality and diversity of knowledge and experience, that prevent any underlying bias which could cause any kind of discrimination, and, in particular, that the procedures should favour the selection of female directors.

In its meeting on November 25, 2015, the Board of Directors approved a Director Selection Policy which is aimed at ensuring that appointment or re-election proposals meet the Board's requirements as set out in a preliminary analysis, encouraging gender equality and diversity of knowledge and experience, without any underlying bias would could cause any kind of discrimination. This Director Selection Policy is available on the Company's corporate website.

In accordance with the aforesaid Policy, candidates to be Telefónica Directors will be selected using the following principles:

1.- The Company will ensure that the Board of Directors has a balanced structure, with an ample majority of non-executive Directors and an adequate proportion between Proprietary and Independent Directors.

2.- The Board of Directors will ensure that Board members are selected using procedures that favour gender equality and diversity of knowledge and experience, and which prevent any underlying bias which could cause any kind of discrimination. It will also ensure that candidates put forward to be non-executive Directors have enough time available to be able to adequately perform their duties.

3.- A preliminary analysis of the Company's and of the Group's requirements will be used in the process of selecting candidates to be Directors. This analysis will be made by the Company's Board of Directors, which will be advised and which will receive a mandatory preliminary report by the Nominating, Compensation and Corporate Governance Committee.

4.- This report by the Nominating, Compensation and Corporate Governance Committee will be published when calling the General Shareholders Meeting at which each Director will be submitted for confirmation, appointment or re-election.

5.- Every year, the Nominating, Compensation and Corporate Governance Committee will check that the Director Selection Policy is complied with, and will report with such information in the Annual Corporate Governance Report.

As far as candidates put forward as Directors are concerned, the Director Selection Policy establishes that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, in fulfilling their respective duties, that all persons proposed for appointment as Directors should be persons of acknowledged solvency, competence and experience who are willing to devote the time and effort necessary to the discharge of their functions, with particular attention paid to the selection of independent Directors.

Candidates put forward as Directors will be persons with a high level of reputation, solvency, experience and training, particularly in the field of telecommunications, economics-finance, accounting, auditing, risk management, and/or business administration, who are able to lead teams consisting of people from different fields of activity, and with extensive experience in major corporations.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates ("recognised calibre, qualifications and experience") and their ability to dedicate themselves to the functions of members of the Board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.

C.1.6 Explain the measures taken, if applicable, by the Nominating Committee to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors, and whether the company makes a conscious effort to search for female candidates who have the required profile.

Explanation of measures

In accordance with Article 10.3 of the Board Regulations, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized calibre, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

The Nominating, Compensation and Corporate Governance Committee analysed and returned a positive opinion of the Director Selection Policy of Telefonía, S.A. approved by the Board of Directors of the company in its meeting held on November 25, 2015.

Furthermore, subject to Article 10.4 of the Regulations of the Board of Directors, the results of the preliminary analysis of the needs of the Board of Directors will be set out in the report of the Nominating, Compensation and Corporate Governance Committee, which will be published on calling the General Shareholders Meeting at which each Director will be submitted for ratification, appointment or re-election.

When, despite the measures taken, there are few or no female directors, explain the reasons.

Explanation of the reasons.

All the measures and processes agreed and adopted by the Board of Directors and the Nominating, Compensation and Corporate Governance Committee to ensure the number of female directors on the Board guarantee an even balance and to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors have been implemented and initiated by the Company.

Thus, in the amendment carried out during the year 2016 in the composition of the Company's Board of Directors, Ms. Sabina Fluxà Thienemann was appointed unanimously by the Board of Directors, at the proposal of the Nominating, Compensation and Corporate Governance, as Independent Director of Telefonía. The Ordinary General Shareholders Meeting of Telefonía, held on May 12, 2016, ratified this appointment.

In the appointment proposal of Ms. Sabina Fluxà Thienemann, the Nominating, Compensation and Corporate Governance Committee considered the solvency, competence, experience, professional merits and willingness of Ms. Fluxà for the effective performance of her functions, only when considering her personal and professional features. This is all to take place within the framework of the Director Selection Policy of the Company which expressly states, with regard to the promotion of Female Directors' presence in the Board of Directors, that it is mandatory for Director's selection procedures to encourage gender diversity, and forbids any type of underlying bias which might cause any form of discrimination.

C.1.6.bis Explain the conclusions of the Nominating Committee regarding verification of compliance with Director selection policy. And, in particular, how this policy is being used towards the target that at least 30% of the total members of the Board of Directors should be female directors by 2020.

Explanation of conclusions.

Since 25 November, 2015, Telefónica S.A. has used a specific and verifiable Director Selection Policy, approved by the Board of Directors, which is aimed at ensuring that Director appointment or re-election proposals meet the Board's requirements as set out in a preliminary analysis, encouraging gender equality and diversity of knowledge and experience.

This policy is public and can be consulted at the corporate website (www.telefonica.com).

Within the framework of such policy, during the year 2016, the Nominating, Compensation and Corporate Governance Committee proposed and informed about the appointment of Directors of Telefónica, S.A., on the basis of solvency, competence, experience, professional merits and willingness of the candidates to devote the time and effort needed for the effective performance of their functions, only when considering their personal and professional features.

On its meeting held on April 7, 2016, the Committee proposed to the Company's Board of Directors, the appointment by co-optation of Ms. Sabina Fluxà Thienemann, Mr. José Javier Echenique Landiribar, Mr. Peter Löscher and Mr. Juan Ignacio Cirac Sasturain as Independent Directors, replacing Mr. Carlos Colomer Casellas, Mr. Alfonso Ferrari Herrero, Mr. José Fernando de Almansa Moreno-Barreda and Mr. Santiago Fernández Valbuena, respectively.

Likewise, the Committee informed and/or proposed the re-election and ratification of the Directors of Telefónica, S.A. by the General Ordinary Shareholders Meeting of the Company, considering and analysing the functions performed and the commitment of the Directors, basing all the proposals on a prior analysis of the Board of Director's needs, and promoting the knowledge, experience and gender diversity.

Thus, the General Ordinary Shareholders Meeting held on May 12, 2016, on the proposal of the Board of Directors, approved the re-election of Mr. Isidro Fainé Casas, Mr. Julio Linares López, Mr. Peter Erskine, and Mr. Antonio Massanell Lavilla, as well as the ratification of the appointment of Ms. Sabina Fluxà Thienemann, Mr. José Javier Echenique Landiribar, Mr. Peter Löscher, Mr. Juan Ignacio Cirac Sasturain and Mr. Wang Xiaochu.

Furthermore, with regards to the promotion of Female Directors' presence in the Board of Directors, it is important to note that the Director Selection Policy expressly states that it is mandatory for Director selection procedures to encourage gender diversity, and forbids any type of underlying bias which might cause any form of discrimination. Notwithstanding the foregoing, the Nominating, Compensation and Corporate Governance Committee and the Board of Directors of the Company have taken into account this premise in all their appointment proposals, re-elections and ratifications of the Directors that were presented, analysed and approved during this year 2016, and specifically the appointment proposal of Ms. Sabina Fluxà Thienemann, approved by the General Ordinary Shareholders Meeting held on May 12, 2016.

C.1.7 Explain how shareholders with significant holdings are represented on the board.

As stated in section C.1.3 of this Annual Corporate Governance Report, at December 31, 2016, the group of external Directors of Telefónica, S.A. was composed of 17 members (out of a total of 18 Members), of whom 5 are proprietary Directors, 9 are independent and 3 fall under the "Other external Directors" category.

Of the five proprietary Directors, two act in representation of Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa", which holds 5.15% of the capital stock of Telefónica, S.A., and two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.33% of the capital; and one in representation of China Unicom (Hong Kong) Limited (China Unicom), which owns 1.27% of the capital stock. The percentages mentioned above refer to December 31, 2016.

C.1.8 Explain, when applicable, the reasons why proprietary directors have been appointed upon the request of shareholders who hold less than 3% of the share capital:

Name or corporate name of shareholder	Reasons
	<p>As explained in Section H "Other information of interest", Note 5 to Section A.6 of this report, on January 23, 2011, expanding on their existing strategic alliance, Telefónica, S.A. and China Unicom (Hong Kong) Limited ("China Unicom") signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica also agreed to propose the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company's Bylaws.</p> <p>On May 18, 2011, the General Shareholders' Meeting approved the appointment of Mr. Chang Xiaobing as Company Director, acting on the proposal made by China Unicom, for the purpose of executing the addendum to the Strategic Partnership Agreement agreed in January 2011. On September 30, 2015, the Board of Directors approved by co-option to appoint Mr. Wang Xiaochu, as a new member of the Board of Directors, as a proprietary Director, to replace Mr. Chang Xiaobing, who decided to step down from his position as Director of Telefónica, S.A., after ceasing in his duties as Chairman and CEO of China Unicom (Hong Kong) Limited, and once Mr. Wang Xiaochu had been appointed to those positions.</p>
China Unicom (Hong Kong) Limited	This commitment to China Unicom is a consequence of the Strategic Partnership, which is intended to strengthen Telefónica's position in the global communications market.

Provide details of any rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors. If so, explain why these requests have not been entertained.

No

C.1.9 Indicate whether any director has resigned from office before their term of office has expired, whether that Director has given the board his/her reasons and through which channel. If made in writing to the whole board, list below the reasons given by that director.

Yes

Name of director	Reasons for resignation
Mr. Carlos Colomer Casellas	Mr. Carlos Colomer Casellas, in order to refresh the Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on April 8, 2016, effective as of this particular time, from its respective position as Director of Telefónica, S.A., and thus from all of his positions within the Board of Directors and within the Committees of such Board.

Name of director	Reasons for resignation
Mr. José Fernando de Almansa Moreno-Barreda	Mr. José Fernando de Almansa Moreno-Barreda, in order to refresh the Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on April 8, 2016, effective as of this particular time, from its respective position as Director of Telefónica, S.A., and thus from all of his positions within the Board of Directors and within the Committees of such Board.

Name of director	Reasons for resignation
Mr. Santiago Fernández Valbuena	Mr. Santiago Fernández Valbuena, in order to refresh the Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on April 8, 2016, effective as of this particular time, from its respective position as Director of Telefónica, S.A., and thus from all of his positions within the Board of Directors and within the Committees of such Board.

Name of director	Reasons for resignation
Mr. Alfonso Ferrari Herrero	Mr. Alfonso Ferrari Herrero, in order to refresh the Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on April 8, 2016, effective as of this particular time, from its respective position as Director of Telefónica, S.A., and thus from all of his positions within the Board of Directors and within the Committees of such Board.

C.1.10 Indicate what powers, if any, have been delegated to the Chief Operating Officer:

Name or corporate name of director	Brief description
Mr. José María Álvarez-Pallete López – Executive Chairman (Chief Executive Officer)	The Chairman of the Company, as the Executive Chairman, has been expressly delegated all the powers of the Board of Directors, except those that cannot be delegated by Law, by the Corporate Bylaws, or by the Regulations of the Board of Directors which establishes, in Article 5.4, the powers that the Board of Directors reserves itself, and may not delegate.

C.1.11 List the directors, if any, who hold office as directors or executives in other companies belonging to the listed company's group:

Name or corporate name of director	Corporate name of the group company	Position	Doers he or she have executive functions?
Mr. César Alierta Izuel	Telefónica Audiovisual Digital, S.L.U.	Director	No
Ms. Eva Castillo Sanz	Telefónica Deutschland Holding, AG	Chairman of Supervisory Board	No
Mr. Peter Erskine	Telefónica Deutschland Holding, AG	Member of Supervisory Board	No
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director	No
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director	No
	Telefónica de Argentina, S.A.	Director	No
	Telefónica Brasil, S.A.	Director	No
	Telefónica Móviles de México, S.A. de C.V.	Director	No
Mr. Francisco Javier de Paz Mancho	Telefónica Ingeniería de Seguridad, S.A.	Chairman	No

C.1.12 List any company board members who sit on the boards of directors of other non-group companies that are listed on official securities markets in Spain, insofar as these have been disclosed to the company:

Name or corporate name of director	Name of listed company	Position
Mr. César Alierta Izuel	China Unicom (Hong Kong) Limited	Director
Ms. Eva Castillo Sanz	Bankia, S.A.	Director
	Banco Sabadell, S.A.	Vice Chairman
	Repsol, S.A.	Director
	ACS, Actividades de Construcción y Servicios, S.A.	Director
Mr. José Javier Echenique Landiribar	Ence, Energía y Celulosa, S.A.	Director
	Gas Natural SDG, S.A.	Chairman
	The Bank of East Asia	Director
Mr. Isidro Fainé Casas	Suez Environnement Company	Director
	Brasil Food, S.A. (BRF)	Director
Mr. Luiz Fernando Furlán	AGCO Corporation	Director
Mr. Pablo Isla Alvarez de Tejera	Inditex, S.A.	Chairman - CEO
Mr. Peter Löscher	OMV Aktiengesellschaft	Chairman

	Sulzer AG	Chairman
	Deutsche Bank AG	Director
	Caixabank, S.A.	Vice Chairman
	Repsol, S.A.	Director
Mr. Antonio Massanell Lavilla	Erste Group Bank AG	Director
Mr. Ignacio Moreno Martínez	Secuoya, Grupo de Comunicación, S.A.	Director
	China United Network Communications Limited	Chairman
Mr. Wang Xiaochu	China Unicom (Hong Kong) Limited	Chairman - CEO

C.1.13 Indicate and, where appropriate, explain whether the Board Regulations establish rules about the maximum number of company boards on which its directors may sit:

Yes

Explanation of rules

As set forth in Article 28.2 of the Regulations of the Board of Directors, the Directors will devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors.

In this regard, persons who belong to over five Board of Directors of other corporations other than Telefónica, S.A. and its Group companies cannot be appointed as Directors.

For these purposes, a) all the Boards of companies which form part of the same Group will be counted as a single Board; and b) Boards of asset-holding companies or companies which are vehicles or complements for the Director's own professional activity, of his/her spouse or person with an analogous affective relationship, or his/her closest relatives, will not be counted.

On an exceptional basis, for justified reasons, the Board will be able to exempt the Director from this prohibition.

C.1.14 Section eliminated.

C.1.15 List the total remuneration paid to the Board of Directors in the year:

Board remuneration (thousands of euros)	10,855
Amount of total remuneration by current directors in accumulated pension rights (thousands of euros)	63,149
Amount of total remuneration by former directors in accumulated pension rights (thousands of euros)	450

C.1.16 List any members of senior management who are not executive directors and indicate total remuneration paid to them during the year:

Name or corporate name	Position(s)
Mr. Ramiro Sánchez de Lerín García-Ovies	General Secretary and of the Board of Directors
Mr. Ángel Vilá Boix	General Manager of Strategy and Finance
Mr. Guillermo Ansaldo Lutz	General Manager of Global Resources
Mr. Eduardo Navarro de Carvalho	Chief Commercial Digital Officer (CCDO)
Mr. Juan Francisco Gallego Arrechea	Director Internal Audit
Total remuneration received by senior management (in thousands of euros)	
	11,075

C.1.17 List, if applicable, the identity of those directors who are likewise members of the boards of directors of companies that own significant holdings and/or group companies:

Name or corporate name of director	Name or corporate name of significant shareholder	Position
		Chairman of Criteria Caixa, S.A.U.
Mr. Isidro Fainé Casas	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Chairman of Patronato Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"
Mr. Antonio Massanell Lavilla	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Vice-Chairman of Caixabank, S.A.

List, if appropriate, any relevant relationships, other than those included under the previous heading, that link members of the Board of Directors with significant shareholders and/or their group companies:

Name or company name of director with relationship	Name or company name of significant shareholder with relationship	Description of relationship
Mr. César Alierta Izuel	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Trustee of Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Early retirement. Formerly General manager of Wholesale and Investment Banking
Mr. Juan Ignacio Cirac Sasturain	Fundación Banco Bilbao Vizcaya Argentaria Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Member of the Scientific Advisory Committee Member of the Advisory Board
Ms. Sabina Fluxà Thienemann	Banco Bilbao Vizcaya Argentaria, S.A.	Member of Regional Advisory Board
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office

C.1.18 Indicate whether any changes have been made to the board regulations during the year:

No

C.1.19 Indicate the procedures for appointing, re-electing, appraising and removing directors. List the competent bodies and the processes and criteria to be followed for each procedure.

See heading H "Other information of interest", Note 11 to Section C.1.19

C.1.20 Explain, if applicable, to what extent this annual evaluation of the Board has prompted significant changes in its internal organization and the procedures applicable to its activities:

Outline of changes

In a meeting on February 23, 2016, the Nominating, Compensation and Corporate Governance Committee revised and analysed the results of the Directors of Telefónica, S.A.'s evaluation in 2015 of the Board of Directors and its Committees and of the Company's General Meeting, concluding that, on the whole, they were highly satisfied with the organisation and activities of these governing bodies.

Furthermore, and as a result of this Evaluation, certain improvement points were identified. In view of this and after an exhaustive examination and analysis of the results obtained, the Board followed the Nominating, Compensation and Corporate Governance Committee's proposal and approved the suggested improvements described hereon in order to optimize the operation of the Company's governing bodies:

- i) Wherever possible, mechanisms will be put in place so that the documentation and information pertaining to the matters to be discussed in the meetings of the Board of Directors and its Committees is provided earlier.

- ii) Identify matters relating to the Committees of the Board of Directors in order to optimise how they are run.
 - iii) Continue implementing measures to ensure that the General Meeting of Shareholders is run as effectively as possible.
 - iv) Broaden the scope of the topics discussed in the Board, and take a more detailed look at the Board's composition.
-

C.1.20.bis Describe the evaluation process and the evaluated areas performed by the Board of Directors, assisted, if applicable, by an external advisor, with regard to diversity in the Board's composition and skills, in the functioning and composition of its Committees, the performance of the Chairman of the Board of Directors and the company CEO, and each Director's performance and contribution.

Every year, all the Company Directors assess the working of the Board of Directors of Telefónica, S.A., that of the Board Committees, the Senior Management and of the General Shareholders Meeting.

Subsequently, the Nominating, Compensation and Corporate Governance Committee reviews and analyses the results of the Directors' assessment, identifying any areas where there is room for improvement. Once it has scrutinised and analysed the results in depth, the Nominating, Compensation and Corporate Governance Committee makes a proposal to the Board of Directors to implement the suggestions and recommendations deemed pertinent.

In the Board of Directors meeting held on 30 November, all the Directors were handed a questionnaire in order to carry out the assessment for 2016.

The questionnaire includes a broad range of questions divided into the following five sections:

- Composition (quantitative and qualitative), working and powers of the Board, expressly including adequate performance and the Directors' contribution to the Board of Directors.
- Composition and working of the Committees, expressly including the performance and contribution of the Chairpersons of the Board of Directors' Committees.
- Adequacy of the performance of the Executive Chairman.
- Directors' Rights and Duties.
- General Shareholders Meeting.

As referred to above, once the questionnaires - filled in with the Directors' opinion and suggestions - were received, action plans regarding the areas where improvement was considered to be needed were set in motion.

The Board of Directors unanimously approved the proposed improvements made by the Nominating, Compensation and Corporate Governance, aimed at optimising the working of the Company's Governance Bodies.

In accordance with the Director Selection Policy, every three years an external consultancy firm will assist the Board of Directors in performing the assessment. The independence of the consultancy firm will be verified by the Nominating, Compensation and Corporate Governance Committee.

C.1.20.ter Details, if applicable, of the business relations which the consulting firm or any Group company has with the company or any company in its group.

C.1.21 Indicate the cases in which directors must resign.

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalise such resignation in the following cases:

- a) When they cease to hold the executive positions to which their appointment as Directors is linked, or when the reasons for which they were appointed no longer exist.

- b) When they are affected by any of the cases of incompatibility or prohibition established by Law.
- c) When they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for having failed to fulfil any of their obligations as Directors.
- d) When their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardise its interests.

The conditions listed above under Recommendation C.1.19 ("Removal") above must also be taken into consideration.

C.1.1.22 Section eliminated.

C.1.1.23 Are qualified majorities, other than legal majorities, required for any type of decisions?

No

If applicable, describe the differences.

C.1.1.24 Indicate whether there are any specific requirements, apart from those relating to the directors, to be appointed Chairman of the Board of Directors.

Yes

Description of requirements

In accordance with Article 31.4 of the Corporate Bylaws, in order for a Director to be appointed Chairman, such Director must have served on the Board for at least three years prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favourable vote of at least 85 percent of the members of the Board of Directors.

C.1.1.25 Indicate whether the Chairman has the casting vote:

No

C.1.1.26 Indicate whether the Bylaws or the regulations of the Board of Directors set any age limit for directors:

No

C.1.1.27 Indicate whether the Bylaws or the regulations of the Board of Directors set a limited term of office for independent directors:

No

C.1.1.28 Indicate whether the Bylaws or board regulations stipulate specific rules on appointing a proxy to the board, the procedures thereof and, in particular, the maximum number of proxy appointments a director may hold. Also provide details if any restriction in the categories in which a proxy may be delegated has been established, beyond the restrictions imposed by applicable legislation. If so, give brief details.

In accordance with Article 19 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavour to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Non-executive Directors may

only delegate their proxy in another non-executive Director. Such proxies may be granted by letter or any other means that, in the Chairman's opinion, ensures the certainty and validity of the proxy granted.

Article 34.4 of the Bylaws also establishes that all Directors who are absent may grant a proxy in writing to another Director who is in attendance, with the right to speak and to vote, at the meeting or session to which the proxy refers. The Director granting the proxy shall endeavour, to the extent possible, to include voting instructions in the proxy document.

C.1.29 Indicate the number of Board meetings held during the year and how many times the board has met without the Chairman's attendance. Attendance will also include proxies appointed with specific instructions.

Number of Board meetings	12
Number of Board meetings held without the Chairman's attendance	0

If the Chairman is a non-executive Director, indicate the number of meetings held, without attendance or proxy of any executive Director and under the Chairmanship of the Lead Independent Director.

Number of meetings	0
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Indicate the number of meetings of the various board committees held during the year.

Executive Commission	17
Audit and Control Committee	13
Nominating, Compensation and Corporate Governance Committee	11
Service Quality and Customer Service Committee	4
Regulation and Institutional Affairs Committee	7
Strategy and Innovation Committee	7

C.1.30 Indicate the number of board meetings held during the year with all members in attendance. Attendance will also include proxies appointed with specific instructions.

Directors' attendance	11
% of attendances of the total votes cast during the year	99.54%

C.1.31 Indicate whether the consolidated and individual financial statements submitted for authorization by the board are certified previously:

No

Identify, where applicable, the person(s) who certified the company's individual and consolidated financial statements prior to their authorisation for issue by the board.

C.1.32 Explain the mechanisms, if any, established by the Board of Directors to prevent the individual and consolidated financial statements it prepares from being submitted to the General Shareholders Meeting with a qualified Audit Report.

Through the Audit and Control Committee, the Board of Directors plays an essential role in supervising the preparation of the Company's financial information, controlling and coordinating the various players that participate in this process.

To achieve this objective, the Audit and Control Committee's work addresses the following basic issues:

A. Supervise internal audit and, in particular:

- a) Safeguard the independence and efficiency of the internal audit function;

- b) Propose the selection, appointment and removal of the person responsible for internal audit;
 - c) Propose the budget for such service;
 - d) Review the internal audit work plan and its annual activities report;
 - e) Receive regular information on its activities; and
 - f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.
- B. Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.
- C. Monitoring the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal risks, and discuss with the auditors significant weaknesses in the internal control system detected during the audit, without compromising their independence at any time. For that purposes, if deemed necessary, it can submit recommendations or proposals to the Board of Directors and an appropriate monitoring period. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:
- a) The types of risk (operational, technological, financial, legal and reputational) facing the Company;
 - b) The risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialise; and
 - c) The control and information systems to be used to control and manage these risks.
- D. Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardise the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.
- In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualised information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.
- E. Issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in the section above, considered individually and as a whole, other than legal audit and in relation to the regime of independence or laws regulating auditing activities.
- F. Analyse and report on economic conditions, the accounting impact, and, if applicable, the proposed exchange ratio in structural and corporative modification transactions which the Company intends to perform, before being submitted to the Board of Directors.
- G. Preliminary reporting to the Board of Directors regarding all matters set out in prevailing legislation and in the Bylaws, and, in particular, concerning:
- 1. The financial information that the Company must periodically disclose;
 - 2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and
 - 3. Related party transactions.

The Audit and Control Committee verifies both the periodical financial information and the Annual Financial Statements, ensuring that all financial information is drawn up according to the same professional principles and

practices. To this effect, the Audit and Control Committee meets whenever appropriate, having held thirteen (13) meetings in the course of 2016.

Furthermore, the External Auditor participates regularly in the Audit and Control Committee meetings, when called to do so by the Committee, to explain and clarify different aspects of the audit reports and other aspects of its work. Additionally and when requested by the Committee, other members of the Company's management and its subsidiaries' management have attended Committee meetings to explain specific matters that are directly within their scope of competence. In particular, managers from the financial department, as well as those in charge of internal audit, have attended these meetings. The members of the Committee have held separate meetings with each of these when it was deemed necessary to closely monitor the preparation of the Company's financial information.

The above notwithstanding, Article 40 of the Regulations of the Board of Directors establishes that the Audit and Control Committee shall ensure that the Board of Directors prepares the final financial statements in a manner that will give no reason for the Auditor to issue a qualified or reserved opinion. However, whenever the Board considers that it should maintain its standards, the Chairman of the Audit and Control Committee shall publicly explain the contents and scope of the discrepancies.

C.1.33 Is the Secretary of the Board also a Director?

No

If the Secretary is not a member of the Board, fill in the following table:

Name or corporate name of Secretary	Representative
Mr. Ramiro Sánchez de Lerín García-Ovies	--

C. 1.34 Section eliminated.

C.1.35 Indicate, where applicable, the specific mechanisms implemented by the company to preserve the independence of the auditor, financial analysts, investment banks and rating agencies.

With regards to the independence of the External Auditor of the Company, Article 40 of the Regulations of the Board of Directors establishes that the Board shall, through the Audit and Control Committee, establish a stable and professional relationship with the Company's Auditor, strictly respecting the independence thereof.

The Audit and Control Committee has a fundamental responsibility, as specified in Article 22 of the Regulations of the Board, to establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardise the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualised information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.

The Committee must also issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion as to whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in the section above, considered individually and as a whole, other than legal audit and in relation to the regime of independence or laws regulating auditing activities.

Article 22 of the Regulations of the Board of Directors stipulates that the Audit and Control Committee submits proposals for the selection, appointment, re-election and replacement of the external auditor to the Board of Directors, and that it shall be held responsible for the selection process in accordance with prevailing laws, and also the conditions for recruiting the external auditor, regularly gathering information about the audit plan and its execution from the auditor, as well as safeguarding its independence in exercising its functions.

Furthermore, the External Auditor has direct access to the Audit and Control Committee and participates regularly in its meetings, in the absence of the Company's management team when this is deemed necessary. To this effect, and in keeping with US legislation on this matter, the External Auditor must inform the Audit and Control Committee at least once a year on the most significant generally accepted auditing policies and practices followed in the preparation of the Company's financial and accounting information affecting key elements in the financial statements which may have been discussed with the management team, and of all relevant communications between the Auditor and the Company's management team. Likewise, as established in Article 40 of the Regulations of the Board of Directors, every year the Auditor will have a meeting with the Board of Directors in plenary session to inform it of the work conducted and about the pattern of the Company's accounting and risks situation.

In accordance with internal company regulations and in line with the requirements imposed by US legislation, the engagement of any service from the Company's External Auditors must always have the prior approval of the Audit and Control Committee. Moreover, the engagement of non-audit services must be done in strict compliance with the Auditing Act (Ley de Auditoría de Cuentas) and the Sarbanes-Oxley Act published in the United States and subsequent regulations. For this purpose, and prior to the engagement of the Auditors, the Audit and Control Committee studies the content of the work to be performed, evaluating any situations that may compromise the External Auditor's independence, and specifically supervises the percentage the fees paid for such services represent in the total revenue of the auditing firm. In this respect, the Company reports the fees paid to the External Auditor, including those paid for non-audit services, in its Notes to the Financial Statements, in accordance with prevailing legislation.

C.1.36 Indicate whether the company has changed its external audit firm during the year. If so, identify the incoming audit firm and the outgoing auditor:

No

Explain any disagreements with the outgoing auditor and the reasons for the same:

C.1.37 Indicate whether the audit firm performs other non-audit work for the company and/or its group. If so, state the amount of fees received for such work and the percentage they represent of the fees billed to the company and/or its group:

No

C.1.38 Indicate whether the audit report on the previous year's financial statements is qualified or includes reservations. Indicate the reasons given by the Chairman of the Audit Committee to explain the content and scope of those reservations or qualifications.

No

C.1.39 Indicate the number of consecutive years during which the current audit firm has been auditing the financial statements of the company and/or its group. Likewise, indicate how many years the current firm has been auditing the accounts as a percentage of the total number of years over which the financial statements have been audited:

	Company	Group
Number of consecutive years	12	12
Number of years audited by current audit firm/Number of years the company's financial statements have been audited (%)	35.30	46.20

C.1.40 Indicate and give details of any procedures through which directors may receive external advice:

Yes

Procedures

Article 27 of the Regulations of the Board of Directors stipulates that in order to receive assistance in the performance of their duties, the Directors or any of the Committees of the Board may request that legal, accounting, financial or other experts be retained at the Company's expense. The engagement must necessarily be related to specific problems of a certain significance and complexity that arise in the performance of their duties.

The decision to retain such services must be communicated to the Chairman of the Board of Directors and shall be formalised through the Secretary to the Board, unless the Board of Directors does not consider such engagement to be necessary or appropriate.

C.1.41 Indicate whether there are procedures for directors to receive the information they need in sufficient time to prepare for meetings of the governing bodies:

Yes

Procedures

The Company, where possible, adopts the measures necessary to ensure that the Directors receive the necessary information, specially drawn up and geared to preparing the meetings of the Board and its Committees, sufficiently in advance. Under no circumstances shall such a requirement not be fulfilled, on the grounds of the importance or the confidential nature of the information, apart from in absolutely exceptional cases.

In this regard, and in accordance with Articles 18 and 20 of the Regulation of the Board of Directors, at the beginning of each year the Board of Directors and its Committees set the calendar of ordinary meetings to be held during the year. The calendar may be amended by resolution of the Board itself, or by decision of the Chairman, in which case the Directors shall be made aware of the amendment as soon as practicable.

Also, at the beginning of the year the Board and its Committees shall prepare an Action Plan detailing the actions to be carried out and their timing for each year, as per their assigned powers and duties.

Likewise, all the meetings of the Board and the Board Committees have a pre-established agenda, which is communicated at least three days prior to the date scheduled for the meeting together with the call for the session. The Agenda for each meeting will clearly state points on which the Board of Directors, or the Executive Committee, have to adopt a decision or resolution.

For the same purpose, the Directors are sent the documentation related to the agenda of the meetings sufficiently in advance. Such information is subsequently supplemented with the written documentation and presentations handed out to the Directors at the meeting. In accordance with Article 19 of the Regulations of the Board of Directors, the Chairman of the Board of Directors organises the debates, promoting and encouraging all Directors to play an active role in the deliberations, safeguarding their right to freely adopt their own position on all matters. Moreover, with the assistance of the Secretary, he shall ensure that the Directors are sent sufficient information to discuss the points set out in the agenda sufficiently in advance of the meeting. He also ensures that sufficient time is given over to discussing strategic matters, and shall encourage debate during meetings, safeguarding the Directors' right to adopt their positions freely on all points discussed.

To provide all the information and clarifications necessary in relation to certain points deliberated, the Group's senior executive officers attend nearly all the Board and Committee meetings to explain the matters within their powers.

Furthermore, and as a general rule, the Regulations of the Board of Directors (Article 26) expressly establish that Directors are granted the broadest powers to obtain information about all aspects of the Company, to examine its books, records, documents and other data regarding corporate transactions. Exercising of this right to receive information shall be channelled through the Chairman or Secretary to the Board of Directors, who shall respond to the requests made by the Directors, providing them with the requested information directly or offering them the proper contacts at the appropriate level of the organisation.

- C.1.42 Indicate and, where appropriate, give details of whether the company has established rules obliging directors to inform the board of any circumstances that might harm the organization's name or reputation, tendering their resignation as the case may be:

Yes

Details of rules

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalise such resignation when their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardises its interests.

Likewise, Article 30.h) of the Regulations establishes that Directors must report to the Board any circumstances related to them that might damage the credit or reputation of the Company as soon as possible.

- C.1.43 Indicate whether any member of the Board of Directors has notified the company that they have been indicted or tried for any of the offences stated in Article 213 of the Spanish Corporations Act:

No

Indicate whether the Board of Directors has examined this matter. If so, provide a justified explanation of the decision taken as to whether or not the director should continue to hold office or, if applicable, detail the actions taken or to be taken by the board.

- C.1.44 List the significant agreements entered into by the company which come into force, are amended or terminate in the event of a change of control of the company due to a takeover bid, and their effects.

1. On April 29, 2013, Telefónica, S.A. and TLK Investment, CV (which belongs to Corporación Multi-Inversiones, or "CMI", a Business Group domiciled in Guatemala) signed an agreement whereby Telefónica and CMI incorporated a joint business venture called Telefónica Centroamérica Inversiones, S.L.U. ("TCI"), in which Telefónica contributed its assets in Central America (except for its Costa Rica assets) and CMI made a monetary contribution of USD 500,000,000. As a result of these contributions, Telefónica owns a 60% interest in the share capital of TCI, while CMI's stake is 40%. This arrangement was completed on August 2, 2013.

Telefónica and CMI also entered into a Shareholders' Pact in TCI, which includes a change of control clause stipulating that if there was a change of control of CMI or Telefónica, the other party would be fully entitled to: (i) exercise the right to acquire (call option) the entire stake held in TCI by the shareholder over which control has changed at the date control changed; or (ii) exercise the right to sell (put option) the entire stake the former held in TCI to the latter. In both cases, the purchase price of the stake shall be TCI's market value calculated by an independent expert.

For the purposes of the Shareholders' Pact, a change of control shall be: (i) in the case of CMI, when the last natural person or corporate body controlling CMI ceases to do so; and (ii) for Telefónica, when a natural person or corporate body not controlling Telefónica assumes control. In both instances, "control" shall be as specified in the International Financial Reporting Standards (IFRS).

2. - Financing agreements:

On February 19, 2015, Telefónica, S.A., as borrower, and a group of credit entities, as lenders, with Citibank International Limited as the agent bank, entered into a syndicated loan amounting to EUR 2,500 million. On the same date, Telefónica, S.A. executed an amendment of another syndicated loan of EUR 3,000 million, formalized on February 18, 2014, with The Royal Bank of Scotland, PLC as the agent bank.

Likewise, on November 17, 2015, Telefónica, S.A. and a group of credit entities, with Banco Bilbao Vizcaya Argentaria, S.A. as the agent bank, formalized a syndicated loan of EUR 3,000 million, which was modified on November 15, 2016 to reflect certain agreements reached between the parties with respect to its economic terms, including a reduction in its amount up to EUR 1,500 million.

On December 11, 2015, Telefónica, S.A., as borrower, and Banco Bilbao Vizcaya Argentaria, S.A. Niederlassung Deutschland, the Bank of Tokyo-Mitsubishi UFJ, Ltd., sucursal en España, Mizuho Bank Ltd, AB Svensk Exportkredit and Société Générale S.A., as lenders, and with the support of Exportkreditnämnden, signed a financing agreement

amounting to USD 750 million. Also on that same date, Telefónica, S.A., as borrower, and Banco Santander, S.A. and Crédit Agricole Corporate and Investment Bank as lenders, with the support of Finnvera Plc, entered into a financing agreement amounting to EUR 500 million.

On March 8, 2016, Telefónica, S.A., as borrower, Export Development Canada and AB Svensk Exportkredit, as lenders, and Banco Bilbao Vizcaya Argentaria, S.A. Niederlassung Deutschland, as the agent, entered into a financing agreement amounting to EUR 300 million.

As provided for in all of the aforementioned contracts, in the event of a change of control in Telefónica, S.A., lenders may, under certain circumstances, require the early termination of these financing agreements.

The financing contracts consider the usual criteria in these types of agreement to determine if there has effectively been a change of control, such as obtaining control of the majority of voting rights, on the appointment of the majority of members of the board of directors, or on the Company's financial and operational policies.

- C.1.45 Identify, in aggregate form and provide detailed information on agreements between the company and its officers, executives and employees that provide indemnities for the event of resignation, unfair dismissal or termination as a result of a takeover bid or other.

Number of beneficiaries

40

Type of beneficiary

Executive Directors, Senior Managers and other Employees

Description of the resolution

With regards to the conditions applicable to termination of contracts, the Executive Chairman Mr. José María Álvarez-Pallete López maintains the conditions of his previous contract which provided for agreed economic compensation for the termination of the employment relationship, where applicable, that can amount to four years' of remuneration at the most. Annual remuneration on which the indemnity is based is the last fixed remuneration and the arithmetic mean of the last two variable remuneration payments received by contract.

Regarding the contracts of members of Senior Management, in general, they are contractually entitled the right to receive the economic compensation indicated below in the event that their employment relationship is ended for reasons attributable to the Company or, in some instances, is due to objective reasons such as a change of control in the Company. However, if the employment relationship is terminated because of a breach attributable to the Executive, he/she will not be entitled to any compensation whatsoever. That notwithstanding, in certain cases the severance benefit to be received by the member of Senior Management according to their contract is not calculated as per these general criteria, but rather is based on other circumstances of a personal or professional nature or on the time when the contract was signed. The agreed economic compensation for the termination of the employment relationship, where applicable, consists of a maximum of three times annual remuneration plus another year based on length of service at the Company. Annual remuneration on which the indemnity is based is the last fixed remuneration and the arithmetic mean of the last two variable remuneration payments received by contract.

Meanwhile, contracts that tie employees to the Company under a common employment relationship do not include indemnity clauses for the termination of their employment. In these cases, the employee is entitled to any indemnity set forth in prevailing labour legislation. However, contracts of some company employees, depending on their level and seniority, as well as their personal or professional circumstances or when they signed their contracts, establish their right to receive compensation in the same cases as in the preceding paragraph, generally consisting of a year and a half of salary. The annual salary on which the indemnity is based is the last fixed salary and the average amount of the last two variable payments received by contract.

Indicate whether these agreements must be reported to and/or authorized by the governing bodies of the company or its group:

	Board of Directors	General Shareholders Meeting
Body authorizing clauses	Yes	No

Is the General Shareholders' Meeting informed of such clauses?

Yes

C.2. Board committees

C.2.1 Give details of all the Committees of the Board of Directors, their members and the proportion of executive, proprietary, independent and other external directors:

EXECUTIVE COMMISSION

Name	Position	Professional category
Mr. José María Álvarez-Pallete López	Chairman	Executive
Mr. Isidro Fainé Casas	Vice Chairman	Proprietary
Mr. José María Abril Pérez	Vice Chairman	Proprietary
Mr. José Javier Echenique Landiribar	Member	Independent
Mr. Peter Erskine	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
% of Executive Directors		14.29%
% of Proprietary Directors		28.57%
% of Independent Directors		57.14%
% of Other External Directors		0.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

The Board of Directors, always subject to the legal provisions in force, delegates all its powers to an Executive Commission, except those that cannot be delegated by Law, by the Corporate Bylaws, or by the Regulations of the Board of Directors.

The Executive Commission provides the Board of Directors with a greater efficiency and effectiveness in the execution of its tasks, since it meets more often.

Pursuant to the provisions of Article 38 of the Corporate Bylaws of Telefónica, S.A., Article 21 of the Regulations of the Board of Directors regulates the Executive Commission in the following terms:

a) Composition.

The Executive Commission shall consist of the Chairman of the Board of Directors, once appointed as a member of the Executive Commission, and not less than three or more than ten Directors appointed by the Board of Directors.

The Board of Directors shall seek to have External Directors constitute a majority over the Executive Directors.

In all cases, the affirmative vote of at least two-thirds of the members of the Board of Directors shall be required in order for the appointment or re-appointment of the members of the Executive Commission to be valid.

b) Operation.

The Executive Commission shall meet whenever called by the Chairman, and shall normally meet every fifteen days.

The Chairman and Secretary to the Board of Directors shall act as the Chairman and Secretary to the Executive Commission. One or more Vice Chairmen and a Deputy Secretary may also be appointed.

A valid quorum of the Executive Commission shall exist with the presence, in person or by proxy, of more than one-half of its members.

Resolutions shall be adopted by a majority of the Directors attending the meeting (in person or by proxy), and in the case of a tie, the Chairman shall cast the deciding vote.

c) Relationship with the Board of Directors.

The Executive Commission shall report to the Board in a timely manner on the matters dealt with and the decisions adopted at the meetings thereof, with a copy of the minutes of such meetings made available to the members of the Board (Article 21.C) of the Regulations of the Board of Directors).

Most significant actions during the year.

During the 2016 year, the Executive Commission of the Board of Directors of Telefónica, S.A. has analysed, reviewed, deliberated upon and adopted resolutions on a range of matters concerning, inter alia:

- The business activity performed by the Telefónica Group: i) products and services (E2E Digitalization, Internet of Things, Security B2B, Network, Terminals, Business Intelligence, Big Data, voice and data, video services, etc.), ii) business performance in the countries in which the Telefónica Group operates, and iii) operational trends.
- Status of regulations in the telecommunications sector (such as regulatory amendments and spectrum auctions).
- Corporate and financing transactions of the Telefónica Group.

Indicate whether the composition of the Executive Commission reflects the participation within the board of the different types of directors:

Yes

AUDIT AND CONTROL COMMITTEE

Name	Position	Professional category
Mr. José Javier Echenique Landiribar	Chairman	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of Proprietary Directors	40.00%
% of Independent Directors	60.00%
% of Other External Directors	0.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 17 to Section C.2.1.

Indicate the Director who sits on the Audit Committee who has been appointed, taking into account his/her knowledge and experience in accounting, auditing or in both, and state how many years the Chairman of this Committee has held this position.

Name or Director with experience
Mr. José Javier Echenique Landiribar
No. years Chairman has held this position
1

NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Position	Professional category
Mr. Francisco Javier de Paz Mancho	Chairman	Independent
Mr. Peter Erskine	Member	Independent
Ms. Sabina Fluxà Thienemann	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Pablo Isla Álvarez de Tejera	Member	Independent
% of Proprietary Directors		0.00%
% of Independent Directors		100.00%
% of Other External Directors		0.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 18 to Section C.2.1.

SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Position	Type
Mr. Antonio Massanell Lavilla	Chairman	Proprietary
Ms. Eva Castillo Sanz	Member	Other External
Mr. Julio Linares López	Member	Other External
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Ignacio Moreno Martínez	Member	Proprietary
% of Proprietary Directors		40.00%
% of Independent Directors		20.00%
% of Other External Directors		40.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

Pursuant to the provisions of Article 25 of the Regulation of the Board of Directors of the Company, the Service Quality and Customer Service Committee is regulated in the following terms:

a) Composition.

The Service Quality and Customer Service Committee shall consist of such a number of members, all of them Directors, as the Board of Directors determines at any given time, who shall in no case be less than three and the majority of whom must be External Directors.

The Chairman of the Service Quality and Customer Service Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the Service Quality and Customer Service Committee shall have at least the following duties:

- 1) To periodically examine, review and monitor the quality indices of the principal services provided by the companies of the Telefónica Group.
- 2) To evaluate levels of customer service provided by the companies of the Group to their customers.

Most significant actions during the year.

In the 4 meetings held by the Quality Committee in 2016, it analysed the quality metrics of the main services provided by Telefónica Group companies, while the levels of commercial attention these companies provide to their customers was assessed.

As with the other Board Committees, the relations between the Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the Directors with the necessary documentation, so that it can take such actions into account when performing its duties.

REGULATION AND INSTITUTIONAL AFFAIRS COMMITTEE

Name	Position	Professional category
Mr. Julio Linares López	Chairman	Other External
Ms. Eva Castillo Sanz	Member	Other External
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent
% of Proprietary Directors		33.33%
% of Independent Directors		33.33%
% of Other External Directors		33.33%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

Subject to article 20.b) of the Board of Directors' Regulation, the Board has created the Regulation and Institutional Affairs Committee:

a) Composition.

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Regulation and Institutional Affairs Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the Regulation and Institutional Affairs Committee shall have, at least, the following duties:

- 1) To carry out, through study, analysis and discussion, permanent monitoring of the main matters and themes of the regulatory order that affect the Telefónica Group at all times.
- 2) To provide a channel for communication and information between the management team and the Board of Directors in statutory matters and, when appropriate, to bring to the knowledge of the latter matters that are considered relevant to the Company, or to any of the companies in the Group and on which it may be necessary or convenient to adopt a decision or to establish a specific strategy.
- 3) To review, report and propose to the Board of Directors the principles that must guide the Group's Sponsorship and Patronage policy, monitor such policy and individually approve all sponsorships or patronages that exceed the limit set by the Board, and that have to be approved by the Board.
- 4) To promote the development of the Telefónica Group's Corporate Reputation and Responsibility project and the implementation of the core values of such Group.

Most significant actions during the year.

The Regulation and Institutional Affairs Committee held 7 meetings in the 2016 year (prior to the reorganization of this Committee –see heading H “Other information of interest”, Note 12-, the Regulatory Committee held one meeting in 2016, and the Institutional Affairs Committee held 4 meetings), have been analysed and debated:

- The regulatory matters of most significance for the Telefónica Group, were set out in the Regulatory Agenda; at global and European Union level, by regions (Europe and Latin America) and by countries. The most significant developments, as set out in the aforementioned Regulatory Agenda, are updated in each meeting, and in the specific documents or reports submitted to the Committee, when deemed advisable.
- A continuous monitoring of, on the one hand, the Sponsorship and Patronage Policy, and the Sponsorships presented by the Institutional Relations and Sponsorships area of Telefónica, S.A., and, on the other hand, the Corporate Social Responsibility of the Telefónica Group and of the most significant issues in this field.

As with the other Board Committees, the relations between this Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the Directors with the necessary documentation, so that it can take such actions into account when performing its duties.

STRATEGY AND INNOVATION COMMITTEE

Name	Position	Professional category
Mr. Peter Erskine	Chairman	Independent
Mr. José María Abril Pérez	Member	Proprietary
Ms. Eva Castillo Sanz	Member	Other External
Mr. Juan Ignacio Cirac Sasurain	Member	Independent
Mr. Peter Löscher	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
% of Proprietary Directors		28.57%
% of Independent Directors		57.14%
% of Other External Directors		14.29%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

Subject to article 20.b) of the Board of Directors' Regulation, the Board has created the Strategy and Innovation Committee:

a) Composition.

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Strategy and Innovation Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the primary duty of the Strategy and Innovation Committee shall be:

- 1) To support the Board of Directors in the analysis and follow up of the global strategy policy of the Telefónica Group.
- 2) To advise and assist in all matters regarding innovation. Its main object is to perform an examination, analysis and periodic monitoring of the Company's innovation projects, to provide guidance and to help ensure its implementation and development across the Group.

Most significant actions during the year.

The Strategy and Innovation Committee held 7 meetings in the 2016 year (prior to the reorganization of this Committee -see heading H "Other information of interest", Note 12-, the Strategy Committee held 4 meetings in 2016, and the Innovation Committee held 3 meetings), in which it analysed a number of different issues, which mainly concerned the telecommunications sector, in keeping with the strategic policy of the Telefónica Group and its business, and questions relating to these matters.

Likewise, it performed a regular monitoring of the Company's innovation projects, providing guidance and offering its support to help ensure its implementation and development across the Group.

As with the other Board Committees, the relations between the Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the directors with the necessary documentation, so that it can take such actions into account when performing its duties.

Action Plan and Report

As for the Board itself, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, all Committees shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

All Committees shall also draw up an internal Activities Report summarizing the main activities and actions taken during the previous year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues addressed by the Committees.

C.2.2 Complete the following table on the number of female directors on the various board committees over the past four years:

	Number of female directors			
	2016 Number %	2015 Number %	2014 Number %	2013 Number %
Executive Commission	0	0	0	0
Audit and Control Committee	0	0	0	0
Nominating, Compensation and Corporate Governance Committee	1 (20.00%)	0	0	0
Service Quality and Customer Service Committee	1 (20.00%)	1 (14.29%)	1 (14.29%)	1 (14.29%)
Regulation and Institutional Affairs Committee	1 (16.67%)	0	0	0
Strategy and Innovation Committee	1(14.29%)	0	0	0

C.2.3 Section eliminated.

C.2.4 Section eliminated.

C.2.5 Indicate, as appropriate, whether there are any regulations governing the board committees. If so, indicate where they can be consulted, and whether any amendments have been made during the year. Also indicate whether an annual report on the activities of each committee has been prepared voluntarily.

The organization and operation of the Board of Directors Committees are governed by the Regulations of the Board of Directors. In particular, the Executive Commission is regulated in Article 38 of the Bylaws, the Audit and Control Committee in Article 39 of the Bylaws, and the Nominating, Compensation and Corporate Governance Committee in Article 40 of the said Bylaws. These documents are available for consultation on the Company's website.

As mentioned in Section C.2.1 above, the Board Committees draw up an internal Activities Report summarising the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

C.2.6 Section eliminated.

D. Related-party and intragroup transactions

D.1 Explain, if applicable, the procedures for approving related-party or intragroup transactions.

Procedure for reporting on approval of related-party transactions.

Article 5 of the Regulations of the Board of Directors includes a number of powers of the Board which cannot be delegated, including the following:

The approval, based on a favourable report by the Audit and Control Committee, of the transactions which the company carries out with directors, significant shareholders or representatives on the board, or related parties.

Also, as set forth in Article 30.f) of the Regulations of the Board of Directors, Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, on the recommendation of the Audit and Control Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors (present in person or by proxy).

Also, Article 38 of the Regulations of the Board of Directors specifically regulates transactions performed with significant shareholders, and establishes that the Board of Directors, based on a favourable report by the Audit and Control Committee, will approve the transactions which the Company or its Group perform with directors, individual or together with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other Group companies or with persons related to them, unless this power is attributable by law to the General Shareholders Meeting.

Directors affected or which represent or which are related to affected shareholders will have to refrain from taking part in the deliberation and voting on the resolution in question.

This approval does not include transactions which, according to prevailing laws, do not require such approval or exemption, i.e. according to Article 529 ter of the Spanish Corporations Act, the transactions which simultaneously fulfil the three following requirements:

- 1.º they are performed by virtue of contracts whose conditions are standardised and are applied on an across-the-board basis to a large number of clients,
- 2.º they are performed at prices or tariffs generally set by the person supplying the goods or services, and
- 3.º their amount is not more than one per cent of the company's annual revenues.

The transactions referred to above shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic public information of the Company upon the terms provided by law.

For the transaction to be approved, it will be necessary to ensure that the transaction does not compromise the capital, or, if applicable, that it is performed on an arm's-length basis and that the process is transparent.

Only where there are imperative grounds of urgency, duly justified, decisions mentioned above could be adopted by delegated bodies or persons, and subsequently ratified by the Board of Directors (article 5.5 of the Regulations of the Board of Directors).

D.2 List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's significant shareholders.

Name or corporate name of significant shareholder	Name or corporate name of the company or its group company	Nature of the relationship	Type of transaction	Amount (Thousands of euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	8,662
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	2,089
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest charged	67
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Others	14,923
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: loans	349,833
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees	327
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: other	243,992
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earning	242,783
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest paid	27,012
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	266
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	2,611
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase of goods (finished or in progress)	254
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest charged	21,946
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Management contracts	523
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	40,308
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	3,278
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Others	544,596
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance arrangements: loans	46,013
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees	313,839
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	218
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	14
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Interest paid	1,584
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Receipt of services	1,643
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Interest charged	343
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Finance arrangements: loans	44,800
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Guarantees	8,236
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Finance arrangements: other	202,904
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	185,083
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Receipt of services	2,138
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Services rendered	66,447
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	42,264
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Operating lease contracts	10,355
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Guarantees	41,826
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Purchase options commitments	83,910
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Other	250,031
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Interest paid	402
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Operating lease contracts	42
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Purchase of goods (finished or in progress)	65,362

D.3 List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's managers or directors.

D.4 List any relevant transactions undertaken by the company with other companies in its group that are not eliminated in the process of drawing up the consolidated financial statements and whose subject matter and terms set them apart from the company's ordinary trading activities.

In any case, list any intragroup transactions carried out with entities in countries or territories considered to be tax havens.

D.5 Indicate the amount from other related-party transactions:

43,000 thousands euros

D.6 List the mechanisms established to detect, determine and resolve any possible conflicts of interest between the company and/or its group, and its directors, management or significant shareholders.

Company policy establishes the following principles governing possible conflicts of interest that may affect Directors, senior executives or significant shareholders:

- With respect to Directors, Article 30 of the Regulations of the Board of Directors establishes that Directors shall inform the Board of Directors of any situation of direct or indirect conflict they may have with the interest of the company. In the event of conflict, the Director affected shall refrain from participating in the deliberation to which the conflict refers.

Moreover, and in accordance with the provisions set out in the Regulations of the Board, Directors shall refrain from participating in votes that affect matters in which they or persons related to them have a direct or indirect interest.

Likewise, the aforementioned Regulations establish that Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, on the recommendation of the Nominating, Compensation and Corporate Governance Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors (present in person or by proxy).

Directors must also report with respect to themselves as well as the persons related thereto (a) the direct or indirect interests held by them and (b) the offices held or duties performed at any company that is in a situation of actual competition with the Company.

For purposes of the provisions of this paragraph, the following shall not be deemed to be in a situation of actual competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled thereby (within the meaning of Article 42 of the Commercial Code); and (ii) companies with which Telefónica, S.A. has established a strategic alliance. Likewise, for purposes of the provisions hereof, proprietary directors of competitor companies appointed at the request of the Company or in consideration of the Company's interest in the capital thereof shall not be deemed to be in a situation of prohibition of competition.

Transactions arising from the duty of loyalty and its exemption regime shall also be subject to prevailing laws.

- Also, Article 38 of the Regulations of the Board of Directors specifically regulates transactions performed with significant shareholders, and establishes that the Board of Directors, based on a favourable report by the Audit and Control Committee, will approve the transactions which the Company or its Group perform with directors, individual or together with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other Group companies or with persons related to them, unless this power is attributable by law to the General Shareholders Meeting.

This approval does not include transactions which, according to prevailing laws, do not require such approval or exemption, i.e. according to Article 529 ter of the Spanish Corporations Act, the transactions which simultaneously fulfil the three following requirements:

- 1.º they are performed by virtue of contracts whose conditions are standardised and are applied on an across-the-board basis to a large number of clients,
- 2.º they are performed at prices or tariffs generally set by the person supplying the goods or services, and
- 3.º their amount is not more than one per cent of the company's annual revenues.

The transactions referred to above shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic public information of the Company upon the terms provided by law.

For the transaction to be approved, it will be necessary to ensure that the transaction does not compromise the capital, or, if applicable, that it is performed on an arm's-length basis and that the process is transparent.

- With respect to senior executives, the Internal Code of Conduct for Securities Markets Issues sets out the general principles of conduct for the persons subject to the said regulations who are involved in a conflict of interest. The aforementioned Code includes all the Company's management personnel within the concept of affected persons.

In accordance with the provisions of this Code, senior executives are obliged to: (a) act at all times with loyalty to the Telefónica Group and its shareholders, regardless of their own or other interests; (b) refrain from interfering in or influencing the making of decisions that may affect individuals or entities with whom there is a conflict; and (c) refrain from receiving information classified as confidential which may affect such conflict. Furthermore, these persons are obliged to inform the Company's Regulatory Compliance function of all transactions that may co-ially give rise to conflicts of interest.

D.7 Is more than one group company listed in Spain?

No

Please specify the subsidiary companies listed in Spain:

Subsidiary company listed

Indicate whether they have provided detailed disclosure on the type of activity they engage in, and any business dealings between them, as well as between the subsidiary and other group companies:

Define possible business relations between the parent company and the listed subsidiary, and between the latter and the other Group companies

Indicate the mechanisms in place to resolve possible conflicts of interest between the listed subsidiary and other group companies:

Mechanisms to resolve possible conflicts of interest

E. Risk control and management systems

E.1 Describe the risk management system in place at the company, including with relation to taxes.

Telefónica continually monitors the most significant risks in the main companies comprising its Group. The Company therefore has a Corporate Risk Management Model based on the model established by the Treadway Commission's Committee of Sponsoring Organizations (COSO), which allows to assess both the impact and the likelihood of occurrence of the various risks arising.

One of the features of this Model is a map prioritizing risks according to their importance, thereby facilitating their management and appropriate response to mitigate them. In accordance with this Model, and based on best practices and benchmarks in risk management, the following four risk categories have been identified:

- i) **Business risk:** Possible loss of value or earnings as a result of strategic uncertainty or uncertainty about competitors, changes in the business, competition and market scenario, or changes in the legal framework.
- ii) **Operational risk:** Possible loss of value or earnings as a result of events caused by inadequacies or failures in customer service, processes, human resources, business teams and IT systems, security, compliance with contracts, laws and regulations, or due to external factors.
- iii) **Financial risk:** Possible loss of value or earnings as a result of adverse movements in financial variables and the inability of the Company to meet its obligations or convert its assets into cash. Additionally the risks of a fiscal nature are included in this category.
- iv) **Global risk:** Possible loss of value or earnings as a result of events that affect in a transversal way the entire Telefónica Group in terms of its corporate reputation and responsibility, corporate public relations, marketing strategy, brand, sponsorship and innovation.

E.2 Identify the bodies responsible for preparing and implementing the risk management system, including tax matters.

Telefónica, S.A.'s Board of Directors reserves the power to approve the general risk policy. The Audit and Control Committee analyzes and evaluates risks and then proposes to the Board of Directors the risk control and management policy to be adopted, identifying the categories of risks to which the Company is exposed, the level of acceptable risk, measures to mitigate the impacts of identified risks, control systems and the reporting to be used to control and manage said risks. The powers and duties of the Audit and Control Committee also include the supervision of the Company's risk management system.

As stated by the Group's Risk Management Policy, various local and corporate units are involved in the risk management process.

The entire organization is responsible for contributing to the identification and management of risks, following the procedures defined to implement and ensure the effectiveness of the Group's risk management processes.

In order to coordinate and report these activities, there is an internal Risk Management function, within the Internal Audit department, reporting functionally to the Audit and Control Committee.

The Group's Fiscal Control Policy establishes the rules for the prevention and management of fiscal risk. The development of the fiscal control function corresponds to the Group's Fiscal Management, which performs this task through the Regional Fiscal Directorates and the local fiscal control officers in the different subsidiaries in accordance with the principles defined in said document.

E.3 Indicate the main risks, including tax risks, which may prevent the company from achieving its targets.

Information regarding this point is contained in the Annex to this Report.

E.4. State whether the company has a risk tolerance level, including tax risk.

The Company has a level of risk tolerance or acceptable risk level established at a corporate level. This threshold represents the extent to which it is prepared to assume a certain level of risk, insofar as it may contribute to generating value and developing the business, achieving an appropriate balance between growth, performance and risk.

The range of risks to which the Company may be exposed described below is considered when evaluating risk:

- Generally, albeit mainly related to operational and business risks, tolerance thresholds are defined pursuant to the impact and probability of the risk. These thresholds are revised annually based on the performance of the main financials for both the Group as a whole and the business lines and main companies therein.
- The tolerance level for financial risks (including fiscal risks) is set in terms of their economic impact.
- A zero-tolerance level is established for global risks, principally those affecting corporate reputation and responsibility.

E.5 Identify any risks, including fiscal risks, which have occurred during the year.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairment in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. In the year 2016, corrections due to impairment of goodwill amounted to 215 million euros were recorded, corresponding to the operations of Telefónica in Venezuela (124 million euros) and in México (91 million euros).

Further details on Income tax matters are provided by Telefónica in its Annual Accounts (Note 17 of the Individual and Consolidated Financial Statements).

E.6 Explain the response and monitoring plans for the main risks the company is exposed to, including fiscal risks.

The Corporate Risk Management Model, which has been devised in accordance with the main international best practices and guidelines, involves identifying and evaluating risks to respond to and monitor them.

Given the diverse range of risks, the mechanisms for responding to risks include overarching initiatives that are developed and coordinated as standard across the Group's main operations and/or specific measures aimed at managing certain risks at company level.

Overarching measures, mainly involving the use of financial derivatives, are taken to mitigate certain financial risks such as those relating to exchange-rate and interest-rate fluctuations. Regarding fiscal risks, the key issues identified are monitored, the Group uses Multinational Programs for insurance or insurance arranged locally in each country to cover operational risks, depending on the type of risk and cover required.

F. Internal Control over Financial Reporting (ICFR) Systems

Describe the mechanisms which comprise the internal control over financial reporting (ICFR) risk control and management system at the company.

F.1 The company's control environment

Specify at least the following components with a description of their main characteristics:

F.1.1 The bodies and/or functions responsible for: (i) the existence and regular updating of a suitable, effective ICFR; (ii) its implementation; and (iii) its monitoring.

The Board of Directors of Telefónica, S.A. (hereinafter Telefónica) assumes ultimate responsibility of ensuring that an adequate and effective internal control over financial reporting system (ICFR) exists and is updated.

The Board of Directors is, in accordance with prevailing laws and the Bylaws, the highest administrative and representative body of the Company, and basically consists of a supervisory and control body, while the executive bodies and management team are responsible for the day-to-day management of the Company's businesses.

The Bylaws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

- Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.
- Monitoring the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal risks, and discuss with the auditors significant deficiencies in the internal control system detected during the audit, without compromising their independence at any time. For that purposes, if deemed necessary, it can submit recommendations or proposals to the Board of Directors and an appropriate monitoring period. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following types of risk (operational, technological, financial, legal and reputational) which the Company faces; the level of risk which the Company deems acceptable; the measures for mitigating the impact of the identified risks should they materialise; and the control and information systems to be employed to control and manage said risks.
- Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardise the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualised information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.
- Issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on whether the independence of the Auditor is compromised. In this report will focus on the assessment of the provision of each and every one of the additional services referred to in previous point, considered individual and in their entirety, other than legal audit, and in relation to the regime of independence or laws regulating auditing activities.

According to the Regulation of the Board of Directors, the Audit and Control Committee must meet at least once every quarter. In practice, the Committee meets every month, and in fact every time it is considered appropriate.

In order to carry out this supervisory function, the Audit and Control Committee is assisted by the entire Company management, including Internal Audit.

All the different areas and functional units of the Telefónica Group are important in ICFR (internal control over financial reporting), the Strategy and Financial areas playing a key role, as they are responsible for preparing, maintaining and updating the different procedures that govern their operations and identify the tasks to be carried out, as well as the persons in charge of the same.

F.1.2 The existence or otherwise of the following components, especially in connection with the financial reporting process:

- **The departments and/or mechanisms in charge of: (i) the design and review of the organizational structure; (ii) defining clear lines of responsibility and authority, with an appropriate distribution of tasks and functions; and (iii) deploying procedures so this structure is communicated effectively throughout the company.**

The Board of Directors is responsible for designing and reviewing the Company's organizational structure, ensuring there is an adequate separation of functions and that satisfactory coordination mechanisms among the different areas are established. The Human Resources Division carries out the deployment of the organizational structure in the respective fields.

Use of the Telefónica Group's economic-financial information system is regulated through several manuals, instructions and internal rules and regulations, internally made available, the most noteworthy of which are as follows:

1. **Corporate Regulations on the Control, Registration and Reporting of Financial and Accounting Information**, which sets out the basic principles of the Telefónica Group's financial and accounting reporting system, and the procedures and mechanisms in place to oversee this system.
2. **Accounting Policies and Measurement Criteria Manual**, designed to unify and standardise the accounting criteria and policies used by all the Group companies to ensure Telefónica operates as a consolidated and uniform group.
3. **Manual for Completion of the Reporting for Consolidation**, which is updated annually and establishes specific instructions for compliance with reporting forms necessary for the preparation of consolidated financial statements and interim consolidated financial information.
4. **Instructions for annual and quarterly accounting closes**, published annually or quarterly to establish the procedures and schedule all Telefónica Group companies must follow when reporting financial and accounting information to enable the Telefónica Group's Consolidation Department to prepare the Group's consolidated financial information, so that Telefónica, S.A. complies with legal and reporting requirements in Spain and the other countries in which its shares are listed.
5. **Annual calendar of financial accounting information**, applicable to all Telefónica Group companies to establish the monthly accounting-financial reporting dates at the start of each period.

These documents define and delimit responsibilities at each level of the organization regarding the reliability of the information published.

The Management levels of the Company are also available on the Group Intranet.

- **Code of conduct, approving body, dissemination and instruction, principles and values covered (stating whether it makes specific reference to record keeping and financial reporting), body in charge of investigating breaches and proposing corrective or disciplinary action.**

In December 2006, Telefónica's Board of Directors approved the unification of the Codes of Ethics of the Group's companies, in the so-called Responsible Business Principles. The Responsible Business Principles, are applied as standard in all countries where the Telefónica Group operates, and for all its employees (affect at all levels of the organization, directors and non-directors).

The Responsible Business Principles are based on a series of general criteria which concern honesty and trust, abidance by prevailing laws, integrity and respect for human rights. It also sets out specific principles focused on ensuring the trust of customers, professionals, shareholders, suppliers and of society at large.

They expressly mention issues related to recording transactions and preparation of financial information: "*We prepare financial and accounting records in an accurate and reliable manner*".

This Code of Ethics is accessible to all employees via the intranet, and procedures are in place in the Telefónica Group to update, monitor adherence to and disseminate these Responsible Business Principles.

Telefónica has an Office of Business Principles, which comprises the most senior representatives of the General Secretary's Office, Human Resources, Public Affairs and Regulation, Chief Commercial Digital Officer (CCDO), Operations, Purchases, Compliance and Internal Audit.

The Office is in charge of:

- 1) **Guaranteeing that Telefónica conducts business in an ethical and responsible manner, and that the Company's reputation is not tarnished.**

- 2) Developing the mechanisms need to ensure the Code of Ethics is followed to the letter in all regions/countries/business units.
- 3) Overseeing, reviewing and contemplating the implementation of the Responsible Business Principles across the entire Telefónica Group.

Training courses are provided to all employees through the online training platform to reinforce knowledge of these Responsible Business Principles.

- 4) Examining any matters or proposals in the Group that could represent a risk to the Business Principles and associated policies and therefore, the brand and reputation.

On a different issue should any type of conduct which does not comply with applicable laws, the Responsible Business Principles or internal regulations come to light, then, after the pertinent analysis, disciplinary measures will be applied in accordance with the regime established in the applicable labour laws, distinguishing between minor, serious and very serious sanctions, depending on the circumstances.

Training programmes are also regularly organised to ensure employees are aware of these rules and principles.

Telefónica also has an "Internal Code of Conduct" for Securities Markets issues, setting out the general guidelines and principles of conduct for the persons involved in securities and financial instrument transactions entered into by the Company and its subsidiaries. The Board of Directors on its meeting held on December 14, 2016, approved a new version of the Internal Code of Conduct in order to adapt it to the regulatory changes on this matter.

- **Whistle-blowing channel, for the reporting to the Audit Committee of any irregularities of a financial or accounting nature, as well as breaches of the code of conduct and malpractice within the organisation, stating whether reports made through this channel are confidential.**

With regard to the whistle-blowing channel, as specified in Article 22 of Telefónica, S.A.'s Regulations for the Board of Directors, the Audit and Control Committee's duties include: "Establishing and maintaining a mechanism to allow employees to confidentially and anonymously report potentially significant irregularities, particularly any financial or accounting irregularities detected within the Company".

The Telefónica Group has two whistle-blowing channels:

SOX Whistle-blowing Channel: this channel was approved by the Audit and Control Committee in April 2004 to fulfil the obligations laid down in the Sarbanes-Oxley Act (SOX), as a listed company on the New York Stock Exchange. It is open to all Telefónica Group employees. Any irregularities reported through the channel must only be related with financial-accounting information, internal controls thereof, and/or audit-related matters.

This channel is confidential and anonymous, since the contents of any reports are sent automatically to the Compliance Department, removing the sender's name, and the source of the message cannot be traced in any event.

The channel is accessible through the Internal Audit webpage on Telefónica's intranet, through the section: Rules of Telefónica's Group, Control over the financial report process.

The Compliance and Internal Audit Departments, as delegate areas of the Audit and Control Committee of Telefónica, S.A., to these purposes, receive all complaints made through this channel regarding internal controls, accounting or the audit of the financial statements, therefore these Departments will be aware about these complaints, will solve them or give the complaints the treatment they deem convenient.

Responsible Business Principles Whistle-blowing Channel: through this channel, professionals can notify the Company of any behaviour, actions or events that could breach the ethical code, the Company's internal rules, or any regulations governing its activity, and jeopardise the contractual relationship between the Company and the accused party. Questions, advice and information on compliance with the Business Principles and associated policies and rules can also be submitted through this channel.

As a general rule, the policy of the Responsible Business Principles Whistle-blowing Channel is not to promote anonymous messages. However the confidentiality of the complainant's identity is safeguarded at all times.

Telefónica S.A.'s Compliance Department is responsible for the Responsible Business Principles Whistle-blowing Channel.

- **Training and refresher courses for personnel involved in preparing and reviewing financial information or evaluating ICFR, which address, at least, accounting rules, auditing, internal control and risk management.**

With regard to employee training in financial and control issues, we would note that in 2007 the Telefónica Corporate University (Universitas Telefónica) was opened to help contribute to the Telefónica Group's advancement through lifelong learning. All the University's training programs are based on developing the corporate culture, the business strategy and management and leadership skills.

Likewise, the Consolidation and Accounting Policies Area offers training plans and seminars to all personnel working in the Group's financial areas and other pertinent areas (tax, M&A, etc.), with the aim of informing them of any accounting or financial changes which are applicable to their job of preparing consolidated financial information. This area also publishes IFRS (International Financial Reporting Standards) information bulletins summarising the main changes to accounting methodology, as well as clarifications on various other related issues.

Financial reporting personnel also attend technical sessions run by external consultancy firms and covering developments in accounting.

Lastly, the Telefónica Group also has an on-line training platform which includes a finance school providing specific training and refresher courses on financial information, as well as an internal control school providing instruction on auditing, internal control and risk management.

F.2. Risk assessment in financial reporting

Report, at least:

F.2.1 The main characteristics of the risk identification process, including risks of error or fraud, stating whether:

- **The process exists and is documented.**

Given the vast number of processes involved in financial reporting at the Telefónica Group, a model has been developed to select the most significant processes by applying a so-called Scope Definition Model, which is documented. This model is applied to the financial information reported by subsidiaries or companies managed by Telefónica. The model selects the accounts with the largest contribution to the Group's consolidated financial information and then identifies the processes used to generate this information. Once the processes have been identified, the risks affecting financial reporting are analysed.

- **The process covers all financial reporting objectives, (existence and occurrence; completeness; valuation; presentation, disclosure and comparability; and rights and obligations), is updated and with what frequency.**

This identification procedure covers all the financial reporting objectives of existence and occurrence, completeness, valuation, presentation, disclosure and fraud. Risk identification is carried out on an annual basis.

- **A specific process is in place to define the scope of consolidation, with reference to the possible existence of complex corporate structures, special purpose vehicles, holding companies, etc.**

In the process of identifying the consolidation scope, the Strategy and Financial Areas regularly updates the consolidation scope, verifying additions and removals of companies with the legal and financial departments of the different companies which are part of the Group, including the corporate departments.

- **The process addresses other types of risk (operational, technological, financial, legal, fiscal, reputational, environmental, etc.) insofar as they may affect the financial statements.**

As indicated above, Telefónica also has a Risk Management Model covering four key areas of risk:

- 1) Business risks
- 2) Operational risks, including, among others Compliance risks
- 3) Global risks
- 4) Financial risks

Financial risks include risks associated with the accuracy, completeness and publication of reporting information. Tax risks are also included within this category:

- **Which of the company's governing bodies is responsible for overseeing the process.**

Pursuant to the provisions of Article 22 of the Regulation of the Board of Directors of Telefónica, S.A., the Board of Directors, through the Audit and Control Committee, supervises this process.

F.3 Control activities.

Indicate the existence of at least the following components, and specify their main characteristics:

F.3.1 Procedures for reviewing and authorizing the financial information and description of ICFR to be disclosed to the markets, stating who is responsible in each case and documentation and flow charts of activities and controls (including those addressing the risk of fraud) for each type of transaction that may materially affect the financial statements, including procedures for the closing of accounts and for the separate review of critical judgments, estimates, evaluations and projections.

On March 26, 2003 Board of Directors of Telefónica, S.A. approved the "Regulations Governing Disclosure and Reporting to the Markets". These regulate the basic principles of operation of the financial disclosure control processes and systems which guarantee that all relevant consolidated financial information of Telefónica, S.A. is communicated to the Company's senior executives and its management team, assigning to the Internal Audit the duty of periodically assessing the functioning of these processes and systems.

Each quarter the Consolidation and Accounting Policies Department submits the periodic financial information to the Audit and Control Committee, highlighting the main events and accounting criteria applied and clarifying any major events which occurred during the period.

Likewise, the Telefónica Group has documented financial processes in place which stipulate common criteria for preparing financial information in all Group companies, as well as any outsourced activities.

The Company also follows documented procedures for preparing consolidated financial information whereby those employees responsible for the different areas are able to verify this information.

Also, and pursuant to the internal regulations, the Executive Chairmen and the Finance Directors of Group companies must submit a certificate to the Corporate Consolidation and Accounting Policies Department stating that they have reviewed the financial information being presented, that the financial statements give a true and fair view, in all material respects, of the financial position, results and cash position, and that there are no significant risks to the business or unhedged risks which may have a material impact on the Company's equity and financial position.

In relation to the accounting close, the Consolidation and Accounting Policies Department issues mandatory instructions setting out the calendar and contents for the financial reporting period for the preparation of the consolidated annual financial statements.

The Corporate Consolidation and Accounting Policies Department reviews the key judgments, estimates, valuations and forecasts to identify critical accounting policies that require the use of estimates and value judgments. In these cases, the Corporate Consolidation and Accounting Policies Department also establishes the necessary operational co-ordination actions with the rest of the Telefónica Group units for their specific areas of activity and knowledge before presenting them to the Audit and Control Committee. The most relevant are dealt with by the Audit and Control Committee. Senior management defines the format for presenting the annual financial statements prior to approval by the Board.

Lastly, Internal Audit, as part of its annual audit plan, among others actions, sets out work plans every year to assess the internal control of financial reporting model.

F.3.2. Internal control policies and procedures for information systems (including secure access, control of changes, system operation, continuity and segregation of duties) giving support to key company processes regarding the preparation and publication of financial information.

The Global Information Systems Department of the Telefónica Group is responsible for the global management of Information Systems for all the Group's businesses, defining strategy and technological planning, ensuring quality in service, cost and security required by the Group.

One of its duties is to develop and implement systems to improve the efficiency, efficacy and profitability of Group processes, the definition and implementation of policies and security standards for applications and infrastructures (in conjunction with the Security and Networks departments), which includes IT aspects of the internal control model.

The Global Security Policy considers human resources and the information, and technological and material resources that support them, to be fundamental assets. For this reason, guaranteeing their security is considered to be an essential asset within the Telefónica strategy, and an essential enabler of the organization's activity.

With the approval of this Policy, the Board of Directors expresses its determination and commitment to reaching a level of security that is adequate to the needs of the business and that homogeneously guarantees the protection of the assets in all Telefónica Group companies.

The security activities developed by the different environments, organizational structures, parties responsible for assets, and employees will be governed by the principles of legality, efficiency, corresponsibility, cooperation, and coordination. Any and all adequate promotion, conduction, control, and improvement measures will be established to this end.

- **Principle of Legality:** the necessary compliance of all national and international laws and regulations regarding the matter of security that may be valid at any given time in any of the territories where the Telefónica Group operates, shall be ensured.
- **Principle of Efficiency:** in order to efficiently reach the required level of security, the anticipatory and preventive nature of said actions shall rule over any passive and reactionary nature. To this end, knowledge of potential threats as well as the analysis of potential risks shall be privileged as part of an intelligence process that identifies and understands the most relevant threats that affect the organization. In order to get ahead of their action and evolution, and to safeguard the Telefónica Group's global organization from their potentially harmful effects, mitigating these risk's damages down to an acceptable level for the business.

A Global Corporate Security Regulations Framework is defined for the purpose of reaching a standardized level of security. This framework will take into account the analyses of risks and threats and will also establish the precise preventive or corrective protection measures.

In addition, strategic plans will be conceived and prepared in order to identify and prioritize the projects and budgets necessary for reaching those adequate levels of security, minimizing the security risks identified in the corresponding analyses, and maximizing the effectiveness of the investment made and the resources used.

- **Principle of Corresponsibility:** users must preserve the security of the assets that Telefónica makes available to them in accordance to the security criteria, requirements, procedures, and technologies defined in the Security Regulations Framework, as well as the applicable laws and regulations regarding the matter of security. At the same time, users must exclusively use the assets for the performance of activities that correspond to their workstation and assigned tasks.
- **Principle of Cooperation and Coordination:** in order to reach the levels of efficiency required by Telefónica business project, the global action and comprehensive concept of security activities shall be preserved together with the aforementioned requirements of anticipation and prevention, cooperation and coordination between all business units and employees will be prioritized, in order to generate the adequate synergies and to jointly reinforce the capabilities.

The Security Organization coordinates the security responsibilities of the different Telefónica Group structures, promoting cooperation between them in order to guarantee the efficient and joint protection of the assets.

Lastly, Internal Audit unit, as part of its annual audit plan, sets out work plans to verify the efficacy and efficiency of the IT governance model, the information security Policy, suitability of controls and data integrity.

F.3.3. Internal control policies and procedures for overseeing the management of outsourced activities, and of the appraisal, calculation or valuation services commissioned from independent experts, when these may materially affect the financial statements.

If a process or part of a process is outsourced to an independent party, controls are still required to ensure the entire process is adequately controlled. Given the importance of outsourcing services and the impacts that this can have on the opinion about ICFR, measures are taken in the Telefónica Group to demonstrate a minimum level of control in the independent party. Actions taken to achieve this objective are three-fold:

- **Certification of internal control by an independent third party:** ISAE3402 and/or SSAE16 certifications.
- **Implementation of specific controls:** identified, designed, implemented and assessed by the Company.
- **Direct assessment:** an assessment carried out by internal audit on certain administrative outsourced processes.

When Telefónica, S.A. or any of its subsidiaries engage the services of an independent expert whose findings may materially affect the consolidated financial statements, as part of the selection process the competence, training, credentials and independence of the third party as regards the methods and main hypothesis used, is verified directly by the area contracting the service and, if applicable with the procurement department. The Strategy and Financial department has established control activities geared towards guaranteeing the validity of data, the methods used, and the reasonability of the assumptions used by the third party using regular monitoring of each function's own KPIs in order to ensure compliance of the outsourced process according to the Group's different policies and guidelines.

Likewise, there is an internal procedure for engaging independent experts which requires specific levels of approval.

F.4 Information and communication

Indicate the existence of at least the following components, and specify their main characteristics:

F.4.1 A specific function in charge of defining and maintaining accounting policies (accounting policies area or department) and settling doubts or disputes over their interpretation, which is in regular communication with the team in charge of operations, and a manual of accounting policies regularly updated and communicated to all the company's operating units.

The Consolidation and Accounting Policies Department of the Group is charged with defining and updating the accounting policies used for preparing the consolidated financial information.

Thus, this area publishes IFRS (International Financial Reporting Standards) information bulletins summarising the main changes to accounting methodology, as well as clarifications on various other related issues, which are systematically monitored by the Accounting Policies area. This bulletins are published on a monthly basis.

Also, the Telefónica Group has an Accounting Policies Manual which is updated annually, the last update took place in December 2016. The objectives of this manual are: to align the corporate accounting principles and policies with IFRS; to maintain accounting principles and policies which ensure that the information is comparable within the Group and offers optimum management of the source of information; to improve the quality of the accounting information of the various Group companies and of the Consolidated Group by disclosing, agreeing and introducing accounting principles which are unique to the Group; and to facilitate the accounting integration of acquired and newly-created companies into the Group's accounting system by means of a reference manual.

This Manual is mandatory for all companies belonging to the Telefónica Group, and shall be applied to their reporting methods when preparing the consolidated financial statements.

This documentation is regularly sent by email and is available for the entire Group on the Telefónica intranet.

The accounting policies area maintains a constant dialogue with the accounting heads of the Group's main operations, both proactively and reactively. This dialogue is useful not only for resolving doubts or conflicts but also to ensure that accounting criteria in the Group are uniform and also for sharing best practices between operators.

F.4.2 Mechanisms in standard format for the capture and preparation of financial information, which are applied and used in all units within the entity or group, and support its main financial statements and accompanying notes as well as disclosures concerning ICFR.

There is a Compliance Manual for Consolidation Reporting which includes specific instructions on preparing the disclosures which comprise the reporting pack reported by all components of the Telefónica Group for the preparation of the Telefónica Group's consolidated financial statements and the consolidated explanatory notes.

Likewise, the Telefónica Group has implemented a specific software system for the reporting of the individual financial statements at its various subsidiaries, as well as the necessary notes and disclosures for preparing the consolidated annual financial statements. This tool is also used to carry out the consolidation process and its subsequent analysis. The system is managed centrally and all components of the Telefónica Group use the same accounts plan.

F.5 System function monitoring

Indicate the existence of at least the following components, describing their main characteristics:

F.5.1 The ICFR monitoring activities undertaken by the Audit Committee and the Company has an internal audit function whose powers include supporting the Audit Committee in its role of monitoring the internal control system, including ICFR. Describe the scope of the ICFR assessment conducted in the year and the procedure for the person in charge to communicate its findings. State also whether the company has an action plan specifying corrective measures for any flaws detected, and whether it has taken stock of their potential impact on its financial information.

As mentioned beforehand, the Corporate Bylaws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties, with its main functions including: supervising the effectiveness of the Company's internal control system and risk management systems, and discussing with the Auditors significant weaknesses in the internal control system detected during the audit.

The Audit and Control Committee is responsible for supervising the effectiveness of the internal controls carried out by the Telefónica Group's Internal Audit function.

The Internal Audit function reports functionally to the Audit and Control Committee, with the primary goal of lending them support in their responsibilities concerning ensuring governance, risk management, and the Group's Internal Control System. Internal Control comprises all process which may reasonably ensure compliance with laws, regulations and internal rules, reliability of information, efficiency and efficacy of operations, and the integrity of the organisation's net worth.

Internal Audit is responsible for implementing the International Standards for the Professional Practice of Internal Auditing and has been awarded a Quality Certificate from the Institute of Internal Auditors.

With regard to supervision of Internal Control over Financial Reporting (ICFR), Telefónica, S.A. is listed on the New York Stock Exchange and is therefore subject to the regulatory requirements established by the US authorities applicable to all companies trading on this exchange.

Among these requirements is the aforementioned Sarbanes-Oxley Act and, specifically, Section 404 which stipulates that all listed companies in the US market must evaluate on an annual basis the effectiveness of their ICFR procedures and internal control structure.

The External Auditor issues its own independent opinion on the effectiveness of financial reporting (ICFR).

Additionally, to fulfil this requirement, the Telefónica Group uses a three-tier (next detailed) internal control of financial reporting evaluation model, while every year the Internal Audit function is responsible for evaluating its performance.

Review of processes and specific controls

In certain companies, in addition to filling out the self-appraisal questionnaire, taking into account the significance of their contribution to the Group's key economic-financial figures and other risk factors considered, their processes and controls are directly reviewed applying the General Assessment Model of the Telefónica Group, which in turn uses the Definition of Scopes Model, in order to identify the critical accounts of each company of the Telefónica Group in accordance with previously established criteria.

Once these critical accounts are identified for review, the General Evaluation Model is applied as follows:

- The processes and systems associated with the critical accounts are determined.
- Risks affecting the financial reporting vis-à-vis these processes are identified.
- Checks and, where necessary, process controls are put in place to provide reasonable assurance that the documentation and design of controls over financial reporting are adequate.
- Audit tests are carried out to assess the effectiveness of the controls.

Review on IT general controls

The Group's general controls are evaluated at least once a year, largely taking into account questions regarding regulations and guidelines applied at global level across the Group.

Supervision of general controls on IT systems is designed to review management of changes to programmes, data and systems access and the operation (management of changes to infrastructure, back ups, scheduled tasks and issues).

If deficiencies in control and/or areas for improvement come to light during the review tasks, the Management will be informed using the reports prepared by the Internal Audit unit, analyzing the impact on the assessment on the internal control system over financial reporting, where appropriate. Once they receive the report, the managers responsible for controls will state the action plans to resolve the identified control deficiencies, and also the estimated periods for them to be implemented.

These Action Plans will have as main objectives:

- Mitigating the deficiency originally defined so that the control works as expected.
- Defining compensatory controls which validate supported processes in case that the original controls cannot be remediated.

Self-appraisal Questionnaires

All the Group's subsidiaries complete self-appraisal questionnaires every year, the responses to which are certified by officers in charge of internal control over financial reporting (ICFR) in each company (Chief Executive Officer (CEO) and Chief Financial Officer (CFO)). These questionnaires cover those aspects of ICFR that are deemed to be minimum requirements to achieve reasonable assurance of the reliability of the financial information. A sample of responses is audited by the Internal Audit unit.

F.5.2 If it has a discussion procedure whereby the auditor (pursuant to TAS), the internal audit function and other experts can report any significant internal control weaknesses encountered during their review of the financial statements or other assignments, to the company's senior management and its Audit Committee or Board of Directors. State also whether the entity has an action plan to correct or mitigate the weaknesses found.

As explained beforehand, the Internal Audit unit also provides support to the Audit and Control Committee in monitoring the correct functioning of the ICFR system. The Internal Audit unit participates in the Audit and Control Committee meetings, and reports regularly on the findings of the performed tasks, as well as action plans established to mitigate and of the degree of implementation thereof. This includes to communicate significant internal control weaknesses which have been identified.

Furthermore, the External Auditor participates in the Audit and Control Committee meetings, when called to do so by the Audit and Control Committee, to explain and clarify different aspects of the audit reports and other aspects of its work, including tasks performed to guarantee the effectiveness of the system of internal control over financial reporting (ICFR). The External Auditor is obliged to communicate the significant internal control weaknesses identified and, for this purpose, has immediate access to the Senior management and the Chairman of the Audit and Control Committee.

F.6 Other relevant information

Not applicable

F.7 External auditor review

State whether:

F.7.1 The ICFR information supplied to the market has been reviewed by the external auditor, in which case the corresponding report should be attached. Otherwise, explain the reasons for the absence of this review. Otherwise, explain the reasons for the absence of this review.

The attached information on ICFR has been submitted to review by the External Auditor, whose report is attached as an appendix to this document.

G Degree of Compliance with Corporate Governance Recommendations

Indicate the extent to which the company follows the recommendations of the Good Governance Code of listed companies.

Should any recommendation not be followed or be only partially followed, a detailed explanation should be given of the reasons so that the shareholders, investors and the market in general have sufficient information to assess the way the company works. General explanations will not be acceptable.

1. The bylaws of listed companies should not place an upper limit on the votes that can be cast by a single shareholder, or impose other obstacles to the takeover of the company by means of share purchases on the market.

Explain

In accordance with Article 26 of the Corporate Bylaws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 percent voting ceiling.

The limitation established in the preceding paragraphs shall also apply to the maximum number of votes that may be collectively or individually cast by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or corporate shareholder and the entity or entities that are shareholders themselves and which are directly or indirectly controlled by such individual or corporate shareholder.

In addition, Article 30 of the Corporate Bylaws stipulates that no person may be appointed as Director unless they have held, for more than three years prior to their appointment, a number of shares of the Company representing a nominal value of at least 3,000 euros, which the Director may not transfer while in office. These requirements shall not apply to those persons who, at the time of their appointment, are related to the Company under an employment or professional relationship, or when the Board of Directors resolves to waive such requirements with the favorable vote of at least 85 percent of its members.

Article 31 of the Corporate Bylaws establishes that, in order for a Director to be appointed Chairman, Vice-Chairman, Chief Executive Officer or member of the Executive Commission, it shall be necessary for such Director to have served on the Board for at least the three years immediately prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

The Corporate Bylaws (Article 26) restrict the number of shares that may be cast by a single shareholder or by shareholders belonging to the same group in order to achieve a suitable balance and protect the position of minority shareholders, thus avoiding a potential concentration of votes among a reduced number of shareholders, which could impact on the guiding principle that the General Shareholders' Meeting must act in the interest of all the shareholders. Telefónica believes that this measure does not constitute a blocking mechanism of takeover bids but rather a guarantee that the acquisition of control required in the interests of all shareholders, an offer for one hundred percent of the capital, because, naturally, and as taught by experience, potential offerors may make their offer conditional upon the removal of the defense mechanism.

In relation to the above and in accordance with the provisions of Article 527 of the Spanish Corporations Act, any clauses in the Bylaws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the offeror has a stake equal to or over 70% of the share capital which confers voting rights, unless the offeror was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

In addition, the special requirements for appointment as Director (Article 30 of the Corporate Bylaws) or as Chairman, Vice-Chairman, Chief Executive Officer or member of the Executive Commission (Article 31 of the Corporate Bylaws) are justified by the desire that access to the management decision-making body and to

the most significant positions thereon is reserved to persons who have demonstrated their commitment to the Company and who, in addition, have adequate experience as members of the Board, such that continuity of the management model adopted by the Telefónica Group may be assured in the interest of all of its shareholders and stakeholders. In any event, these special requirements may be waived by broad consensus among the members of the Board of Directors, namely, with the favorable vote of at least 85 percent of its members, as provided by the aforementioned Articles of the Corporate Bylaws.

2. **When a dominant and a subsidiary company are both listed, they should provide detailed disclosure on:**
 - a) **The activity they engage in and any business dealings between them, as well as between the listed subsidiary and other group companies.**
 - b) **The mechanisms in place to resolve possible conflicts of interest.**

Not applicable

3. **During the annual general meeting the Chairman of the Board should verbally inform shareholders in sufficient detail of the most relevant aspects of the company's corporate governance, supplementing the written information circulated in the Annual Corporate Governance Report. In particular:**
 - a) **Changes taking place since the previous annual general meeting.**
 - b) **The specific reasons for the company not following a given Good Governance Code recommendation and any alternative procedures followed in its stead.**

Complies

4. **The company should draw up and implement a policy of communication and contacts with shareholders, institutional investors and proxy advisors that complies in full with market abuse regulations and accords equitable treatment to shareholders in the same position.**

This policy should be disclosed on the company's website, complete with details of how it has been put into practice and the identities of the relevant interlocutors or those charged with its implementation.

Complies

5. **The Board of Directors should not make a proposal to the general meeting for the delegation of powers to issue shares or convertible securities without pre-emptive subscription rights for an amount exceeding 20% of capital at the time of such delegation.**

When a board approves the issuance of shares or convertible securities without pre-emptive subscription rights, the company should immediately post a report on its website explaining the exclusion as envisaged in company legislation.

Complies

6. **Listed companies drawing up the following reports on a voluntary or compulsory basis should publish them on their website well in advance of the annual general meeting, even if their distribution is not obligatory:**
 - a) **Report on auditor independence.**

- b) **Reviews of the operation of the Audit Committee and the Nomination and Remuneration Committee.**
- c) **Audit Committee report on third-party transactions.**
- d) **Report on corporate social responsibility policy.**

Complies

- 7. The company should broadcast its general meetings live on the corporate website.**

Explain

The Company decided not to offer a live webcast of its 2016 General Shareholders Meeting, for organisational reasons and owing to the way the Meeting was developed (possible changes which could arise). Nonetheless, Telefónica is analysing the possibility of broadcasting future General Shareholders meetings live on its website.

- 8. The Audit Committee should strive to ensure that the Board of Directors can present the company's accounts to the general meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the Chairman of the Audit Committee and the auditors should give a clear account to shareholders of their scope and content.**

Complies

- 9. The company should disclose its conditions and procedures for admitting share ownership, the right to attend general meetings and the exercise or delegation of voting rights, and display them permanently on its website.**

Such conditions and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner.

Complies

- 10. When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the general meeting, the company should:**

- a) **Immediately circulate the supplementary items and new proposals.**
- b) **Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the Board of Directors.**
- c) **Put all these items or alternative proposals to the vote applying the same voting rules as for those submitted by the Board of Directors, with particular regard to presumptions or deductions about the direction of votes.**
- d) **After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.**

Not applicable

11. In the event that a company plans to pay for attendance at the general meeting, it should first establish a general, long-term policy in this respect.

Not applicable

12. The Board of Directors should perform its duties with unity of purpose and independent judgement, according the same treatment to all shareholders in the same position. It should be guided at all times by the company's best interest, understood as the creation of a profitable business that promotes its sustainable success over time, while maximising its economic value.

In pursuing the corporate interest, it should not only abide by laws and regulations and conduct itself according to principles of good faith, ethics and respect for commonly accepted customs and good practices, but also strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.

Complies

13. The Board of Directors should have an optimal size to promote its efficient functioning and maximize participation. The recommended range is accordingly between five and fifteen members.

Explain

The complexity of the Telefónica Group organizational structure, given the considerable number of companies it comprises, the variety of sectors it operates in, its multinational nature, as well as its economic and business relevance, justify the fact that the number of members of the Board is adequate to achieve an efficient and operative operation.

It is important to bear in mind that the Board of Directors of the Company have six Committees (the Executive Commission and five Advisory Committees), which ensures the active participation of all its Directors.

14. The Board of Directors should approve a Director selection policy that:

- a) Is concrete and verifiable.
- b) Ensures that the appointment or reelection proposals are based on a prior analysis of the Board's needs.
- c) Favours a diversity of knowledge, experience and gender.

The results of the prior analysis of board needs should be written up in the Nomination Committee's explanatory report, to be published when the general meeting is convened that will ratify the appointment and re-election of each Director.

The director selection policy should pursue the goal of having at least 30% of total board places occupied by women Directors before the year 2020.

The Nomination Committee should run an annual check on compliance with the director selection policy and set out its findings in the Annual Corporate Governance Report.

Complies

- 15. Proprietary and independent Directors should constitute an ample majority on the Board of Directors, while the number of Executive Directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.**

Complies

- 16. The percentage of Proprietary Directors out of all Non-executive Directors should be no greater than the proportion between the ownership stake of the shareholders they represent and the remainder of the company's capital.**

This criterion can be relaxed:

- a) In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.**
- b) In companies with a plurality of shareholders represented on the Board but not otherwise related.**

Explain

The aforementioned recommendation 16 refers to the composition of the group of External Directors. As stated in Section C.1.3 of this Annual Corporate Governance Report, at 31 December 2016, the group of External Directors of Telefónica, S.A. was composed of 17 members (of a total of 18 Members), of whom 5 are Proprietary Directors, 9 are Independent Directors and 3 falls under the "Other External Directors" category.

Of the five Proprietary Directors, two act in representation of Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa", which holds 5.15% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.33% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.27% stake.

Applying the proportional criterion established in Article 243 of the LSC regarding the total number of Directors, the stakes held by "la Caixa" and BBVA are sufficient to entitle each entity to appoint a Director.

Moreover, it must be taken into account that recommendation 16 stipulates that this strict proportionality criterion can be relaxed so the weight of Proprietary Directors is greater than would strictly correspond to the total percentage of capital they represent in large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.

In this regard, Telefónica ranks among the top listed companies on Spanish stock exchanges in terms of stock market capitalization, reaching the figure of 44,433 million euros at December 31, 2016, which means a very high absolute value of the stakes of "la Caixa" and BBVA in Telefónica (that of "la Caixa" is 2,288 million euros, and that of BBVA is 2,319 million euros). This justifies the overrepresentation of these entities on the Board of Directors, rising from one member of the Board each (to which they would strictly have the right in accordance with Article 243 of the Spanish Corporations Act) to two members, i.e. permitting the appointment of just one more Proprietary Director over the strictly legal proportion.

On January 23, 2011, China Unicom and Telefónica, S.A. expanded on their existing strategic alliance and signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. In recognition of China Unicom's stake in Telefónica, approval was given at Telefónica's General Shareholders' Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

- 17. Independent Directors should be at least half of all board members.**

However, when the company does not have a large market capitalisation, or when a large cap company has shareholders individually or concertedly controlling over 30 percent of capital, independent Directors should occupy, at least, a third of board places.

Complies

18. Companies should disclose the following Director particulars on their websites and keep them regularly updated:
- a) Background and professional experience.
 - b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.
 - c) Statement of the Director class to which they belong, in the case of proprietary Directors indicating the shareholder they represent or have links with.
 - d) Dates of their first appointment as a board member and subsequent re-elections.
 - e) Shares held in the company, and any options on the same.

Complies

19. Following verification by the Nomination Committee, the Annual Corporate Governance Report should disclose the reasons for the appointment of proprietary Directors at the urging of shareholders controlling less than 3 percent of capital; and explain any rejection of a formal request for a board place from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary Directorship.

Complies

20. Proprietary Directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary Directors, the latter's number should be reduced accordingly.

Complies

21. The Board of Directors should not propose the removal of independent Directors before the expiry of their tenure as mandated by the Bylaws, except where they find just cause, based on a proposal from the Nomination Committee. In particular, just cause will be presumed when Directors take up new posts or responsibilities that prevent them allocating sufficient time to the work of a board member, or are in breach of their fiduciary duties or come under one of the disqualifying grounds for classification as independent enumerated in the applicable legislation.

The removal of independent Directors may also be proposed when a takeover bid, merger or similar corporate transaction alters the company's capital structure, provided the changes in board membership ensue from the proportionality criterion set out in recommendation 16.

Complies

22. Companies should establish rules obliging Directors to disclose any circumstance that might harm the organisation's name or reputation, tendering their resignation as the case may be, and, in particular, to inform the Board of any criminal charges brought against them and the progress of any subsequent trial.

The moment a Director is indicted or tried for any of the offences stated in company legislation, the Board of Directors should open an investigation and, in light of the particular circumstances, decide whether or not he or she should be called on to resign. The Board should give a reasoned account of all such determinations in the Annual Corporate Governance Report.

Complies

23. Directors should express their clear opposition when they feel a proposal submitted for the Board's approval might damage the corporate interest. In particular, independents and other Directors not subject to potential conflicts of interest should strenuously challenge any decision that could harm the interests of shareholders lacking board representation.

When the Board makes material or reiterated decisions about which a Director has expressed serious reservations then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next recommendation.

The terms of this recommendation also apply to the secretary of the Board, even if he or she is not a Director.

Complies

24. Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the Board. Whether or not such resignation is disclosed as a material event, the motivating factors should be explained in the Annual Corporate Governance Report.

Complies

25. The Nomination Committee should ensure that Non-executive Directors have sufficient time available to discharge their responsibilities effectively.

The Board of Directors regulations should lay down the maximum number of company boards on which Directors can serve.

Complies

26. The Board should meet with the necessary frequency to properly perform its functions, eight times a year at least, in accordance with a calendar and agendas set at the start of the year, to which each Director may propose the addition of initially unscheduled items.

Complies

27. Director absences should be kept to a strict minimum and quantified in the Annual Corporate Governance Report. In the event of absence, Directors should delegate their powers of representation with the appropriate instructions.

Complies

28. When Directors or the secretary express concerns about some proposal or, in the case of Directors, about the company's performance, and such concerns are not resolved at the meeting, they should be recorded in the minute book if the person expressing them so requests.

Complies

29. The company should provide suitable channels for Directors to obtain the advice they need to carry out their duties, extending if necessary to external assistance at the company's expense.

Complies

30. Regardless of the knowledge Directors must possess to carry out their duties, they should also be offered refresher programmes when circumstances so advise.

Complies

31. The agendas of board meetings should clearly indicate on which points Directors must arrive at a decision, so they can study the matter beforehand or gather together the material they need.

For reasons of urgency, the Chairman may wish to present decisions or resolutions for board approval that were not on the meeting agenda. In such exceptional circumstances, their inclusion will require the express prior consent, duly minuted, of the majority of Directors present.

Complies

32. Directors should be regularly informed of movements in share ownership and of the views of major shareholders, investors and rating agencies on the company and its group.

Complies

33. The Chairman, as the person charged with the efficient functioning of the Board of Directors, in addition to the functions assigned by law and the company's bylaws, should prepare and submit to the Board a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the Board and, where appropriate, the company's chief executive officer; exercise leadership of the Board and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each Director, when circumstances so advise.

Complies

34. When a lead independent Director has been appointed, the Bylaws or Board of Directors regulations should grant him or her the following powers over and above those conferred by law: chair the Board of Directors in the absence of the Chairman and Vice-Chairman give voice to the concerns of Non-executive Directors; maintain contacts with investors and shareholders to hear their views and develop a balanced understanding of their concerns, especially those to do with the company's corporate governance; and coordinate the Chairman's succession plan.

Complies

35. The Board Secretary should strive to ensure that the Board's actions and decisions are informed by the governance recommendations of the Good Governance Code of relevance to the company.

Complies

36. The Board in full should conduct an annual evaluation, adopting, where necessary, an action plan to correct weakness detected in:

- a) The quality and efficiency of the Board's operation.
- b) The performance and membership of its Committees.
- c) The diversity of board membership and competences.
- d) The performance of the Chairman of the Board of Directors and the company's chief executive.
- e) The performance and contribution of individual Directors, with particular attention to the chairmen of board committees.

The evaluation of board committees should start from the reports they send the Board of Directors, while that of the Board itself should start from the report of the nomination committee.

Every three years, the Board of Directors should engage an external facilitator to aid in the evaluation process. This facilitator's independence should be verified by the nomination committee.

Any business dealings that the facilitator or members of its corporate group maintain with the company or members of its corporate group should be detailed in the Annual Corporate Governance Report.

The process followed and areas evaluated should be detailed in the Annual Corporate Governance Report.

Complies

37. When an Executive Committee exists, its membership mix by Director class should resemble that of the Board. The Secretary of the Board should also act as secretary to the Executive Committee.

Complies

38. The Board of Directors should be kept fully informed of the business transacted and decisions made by the Executive Committee. To this end, all board members should receive a copy of the committee's minutes.

Complies

39. All members of the Audit Committee, particularly its Chairman, should be appointed with regard to their knowledge and experience in accounting, auditing and risk management matters. A majority of Committee places should be held by independent Directors.

Complies

40. Listed companies should have a unit in charge of the internal audit function, under the supervision of the Audit Committee, to monitor the effectiveness of reporting and control systems. This unit should report functionally to the Board's Non-executive Chairman or the Chairman of the Audit Committee.

Complies

41. The head of the unit handling internal audit function should present an annual work programme to the Audit Committee, inform it directly of any incidents arising during its implementation and submit an activities report at the end of each year.

Complies

42. The Audit Committee should have the following functions over and above those legally assigned:

1° With respect to internal control and reporting systems:

- a) Monitor the preparation and the integrity of the financial information prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.
- b) Ensure the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.
- c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2° With regard to the external auditor:

- a) Investigate the issues giving rise to the resignation of the external auditor, should this come about.
- b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.
- c) Ensure that the company notifies any change of external auditor to the CNMV as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.
- d) Ensure that the external auditor has a yearly meeting with the Board in full to inform it of the work undertaken and developments in the company's risk and accounting positions.

- e) **Ensure that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.**

Complies

- 43. **The Audit Committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.**

Complies

- 44. **The Audit Committee should be informed of any fundamental changes or corporate transactions the company is planning, so the committee can analyse the operation and report to the Board beforehand on its economic conditions and accounting impact and, when applicable, the exchange ratio proposed.**

Complies

- 45. **Risk control and management policy should identify at least:**

- a) **The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance sheet risks.**
- b) **The determination of the risk level the company sees as acceptable.**
- c) **The measures in place to mitigate the impact of identified risk events should they occur.**
- d) **The internal control and reporting systems to be used to control and manage the above risks, including contingent liabilities and off-balance sheet risks.**

Complies

- 46. **Companies should establish a risk control and management function in the charge of one of the company's internal department or units and under the direct supervision of the Audit Committee or some other dedicated board committee. This function should be expressly charged with the following responsibilities:**

- a) **Ensure that risk control and management systems are functioning correctly and, specifically, that major risks the company is exposed to are correctly identified, managed and quantified.**
- b) **Participate actively in the preparation of risk strategies and in key decisions about their management.**
- c) **Ensure that risk control and management systems are mitigating risks effectively in the frame of the policy drawn up by the Board of Directors.**

Complies

- 47. Appointees to the Nomination and Remuneration Committee – or of the Nomination Committee and Remuneration Committee, if separately constituted – should have the right balance of knowledge, skills and experience for the functions they are called on to discharge. The majority of their members should be Independent Directors.**

Complies

- 48. Large cap companies should operate separately constituted Nomination and Remuneration Committees.**

Explain

Article 40 of the Bylaws, and Article 23 of the Regulation of the Board of Directors, expressly state, on regulating the Nominating, Compensation and Corporate Governance Committees, that the Board of Directors shall be entitled to set up two Committees, separately giving each of them powers for appointments, and the other the powers for remuneration, while the corporate governance powers may be included in either one of them.

The Board of Directors of Telefónica, S.A. has not considered appropriate, so far, separating the functions of the Nominating, Compensation and Corporate Governance Committee) because it believes that by putting the powers to assess Directors and determine their remuneration in the same Committee, is helpful to coordinate and to produce a results-driven remuneration system (pay for performance). Furthermore, it is noted that the Board of Directors currently has five Consultative Committees (Audit and Control Committee, the Nominating, Compensation and Corporate Governance Committee, Regulation and Institutional Affairs Committee, Service Quality and Customer Care Committee and the Strategy and Innovation Committee), in addition to the Executive Commission.

In this context, the separation of the Nominating, Compensation and Corporate Governance Committee would not have been appropriate with the facilitating objective of the recent reorganization, generating unnecessary inefficiencies and needs for additional allocations.

Furthermore, the Board of Directors, on its meeting held on April 27, 2016, after a favourable report of the Nominating, Compensation and Corporate Governance Committee and a formal deliberation, approved a new setting of the Advisory or Control Committees of the Company in with regards to its organization, structure and composition in order to increase the efficiency and to optimize the management of the corporate governance structure of Telefónica, S.A.

- 49. The Nomination Committee should consult with the company's Chairman and chief executive, especially on matters relating to Executive Directors.**

When there are vacancies on the Board, any Director may approach the Nomination Committee to propose candidates that it might consider suitable.

Complies

- 50. The Remuneration Committee should operate independently and have the following functions in addition to those assigned by law:**

- a) Propose to the Board the standard conditions for senior officer contracts.**
- b) Monitor compliance with the remuneration policy set by the company.**
- c) Periodically review the remuneration policy for Directors and senior officers, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other Directors and senior officers in the company.**

- d) **Ensure that conflicts of interest do not undermine the independence of any external advice the Committee engages.**
- e) **Verify the information on Director and senior officers' pay contained in corporate documents, including the annual Directors' remuneration statement.**

Complies

- 51. The Remuneration Committee should consult with the company's Chairman and chief executive, especially on matters relating to Executive Directors and senior officers.**

Complies

- 52. The terms of reference of supervision and control committees should be set out in the Board of Directors regulations and aligned with those governing legally mandatory board committees as specified in the preceding sets of recommendations. They should include at least the following terms:**

- a) **Committees should be formed exclusively by Non-executive Directors, with a majority of independents.**
- b) **They should be chaired by independent Directors.**
- c) **The Board should appoint the members of such committees with regard to the knowledge, skills and experience of its Directors and each committee's terms of reference; discuss their proposals and reports; and provide report-backs on their activities and work at the first board plenary following each committee meeting.**
- d) **They may engage external advice, when they feel it necessary for the discharge of their functions.**
- e) **Meeting proceedings should be minuted and a copy made available to all board members.**

Explain

1. The supervision and control committees which are attributed the powers referred to in recommendation 52 are the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee. The composition and operation rules of the two Committees are set out in the Regulation of the Board of Directors and are not only consistent with legally dispositions applicable but are also an improvement upon them, in certain areas. For example, according to the Regulation of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee must have a majority of independent members, as opposed to the minimum of two according to prevailing laws. In fact, in practice the five members of this committee are all independent.

2. The Board of Directors has other Consultative Committees which are allocated other functions (Regulation and Institutional Affairs Committee, Service Quality and Customer Service Committee, Strategy and Innovation Committee), which are strongly linked with the businesses developed by the Company and with management aspects.

These Committees are not expressly regulated in the Regulation of the Board of Directors or they are regulated with fewer details as those which are legally mandatory.

In particular, it has been decided that Committees with powers in matters linked to the Company's businesses and management aspects do not necessarily have to be chaired by independent Directors nor do most of the members of the committees need to have independent directors, but that it is preferable to take into account the technical knowledge and specific expertise of their members when appointing the Director to chair them and the other Directors who should sit on these committees.

53. The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one board committee or split between several, which could be the Audit Committee, the Nomination Committee, the Corporate social responsibility Committee, where one exists, or a dedicated committee established ad hoc by the Board under its powers of self-organisation, with at the least the following functions:
- a) Monitor compliance with the company's internal codes of conduct and corporate governance rules.
 - b) Oversee the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.
 - c) Periodically evaluate the effectiveness of the company's corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.
 - d) Review the company's corporate social responsibility policy, ensuring that it is geared to value creation.
 - e) Monitor corporate social responsibility strategy and practices and assess compliance in their respect.
 - f) Monitor and evaluate the company's interaction with its stakeholder groups.
 - g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.
 - h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

Complies

54. The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:
- a) The goals of its corporate social responsibility policy and the support instruments to be deployed.
 - b) The corporate strategy with regard to sustainability, the environment and social issues.
 - c) Concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.
 - d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.
 - e) The mechanisms for supervising non-financial risk, ethics and business conduct.
 - f) Channels for stakeholder communication, participation and dialogue.
 - g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

Complies

55. The company should report on corporate social responsibility developments in its Directors' report or in a separate document, using an internationally accepted methodology.

Complies

56. Director's remuneration should be sufficient to attract individuals with the desired profile and compensate the commitment, abilities and responsibility that the post demands, but not so high as to compromise the independent judgement of Non-executive Directors.

Complies

57. Variable remuneration linked to the company and the Director's performance, the award of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements, and membership of long-term savings schemes such as pension plans should be confined to Executive Directors.

The company may consider the share-based remuneration of Non-executive Directors provided they retain such shares until the end of their mandate. This condition, however, will not apply to shares that the Director must dispose of to defray costs related to their acquisition.

Complies

58. In the case of variable awards, remuneration policies should include limits and technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, or circumstances of that kind.

In particular, variable remuneration items should meet the following conditions:

- a) Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.
- b) Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.
- c) Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards ongoing achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.

Complies

59. A major part of variable remuneration components should be deferred for a long enough period to ensure that predetermined performance criteria have effectively been met.

Complies

60. Remuneration linked to company earnings should bear in mind any qualifications stated in the external auditor's report that reduce their amount.

Not applicable

- 61. A major part of Executive Directors' variable remuneration should be linked to the award of shares or financial instruments whose value is linked to the share price.**

Complies

- 62. Following the award of shares, share options or other rights on shares derived from the remuneration system, Directors should not be allowed to transfer a number of shares equivalent to twice their annual fixed remuneration, or to exercise the share options or other rights on shares for at least three years after their award.**

The above condition will not apply to any shares that the Director must dispose of to defray costs related to their acquisition.

Explain

On December 31, 2016, the only Executive Director of the company, Mr. José María Álvarez-Pallete López held a shareholding at Telefónica, S.A., which amounted to 1,230,745 voting rights, which were valued with a price of 8.82 euros per share, represented 564% of his fixed remuneration. In this regard, it is noted that since his appointment as Executive Chairman, Mr. Álvarez-Pallete, as a demonstration of his commitment with Telefónica, has acquired a total of 677,491 shares.

This shareholding owned demonstrate his commitment to Telefónica, and show that his own interests are aligned with the other shareholders' interests.

- 63. Contractual arrangements should include provisions that permit the company to reclaim variable components of remuneration when payment was out of step with the Director's actual performance or based on data subsequently found to be misstated.**

Partially complies

The Nominating, Compensation and Corporate Governance Committee is empowered to propose that the Board of Directors cancels a variable remuneration payment in the event of circumstances such as those described in this recommendation. The Nominating, Compensation and Corporate Governance Committee will also assess if exceptional circumstances of this kind may even entail the termination of the relationship with the person responsible, proposing measures which are deemed pertinent to the Board of Directors.

- 64. Termination payments should not exceed a fixed amount equivalent to two years of the Director's total annual remuneration and should not be paid until the company confirms that he or she has met the predetermined performance criteria.**

Explain

With regards to the conditions applicable to termination of contracts, the Executive Chairman Mr. José María Álvarez-Pallete López maintains the conditions of his previous contract which provided for agreed economic compensation for the termination of the employment relationship, where applicable, that can amount to four years' of remuneration at the most. Annual remuneration on which the indemnity is based is the last fixed remuneration and the arithmetic mean of the last two variable remuneration payments received by contract.

H Other information of interest

1. **If you consider that there is any material aspect or principle relating to the corporate governance practices followed by your company that has not been addressed in this report and which is necessary to provide a more comprehensive view of the corporate governance structure and practices at the company or group, explain briefly.**

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2. **You may include in this Section any other information, clarification or observation related to the above sections of this report, provided that they are relevant and non-reiterative.**

Specifically indicate whether the company is subject to corporate governance legislation from a country other than Spain and, if so, include the compulsory information to be provided when different to that required by this report.

3. **The company may also state whether it voluntarily subscribes to other international, sectorial or other ethical principles or standard practices. If applicable, identify the name of the code and the date of subscription.**

GENERAL CLARIFICATION: It is hereby stated that the details contained in this report refer to the financial year ended on December 31, 2016, except in those issues in which a different date of reference is specifically mentioned.

- Note 1 to Section A.2.]

In accordance with the submitted communication by Blackrock, Inc. to the CNMV on September 16 and 23, 2016, the details of the control chain through this entity owns the voting right and/or the financial instruments is the following:

1.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Group Limited, BlackRock Investment Management (UK) Limited.

2.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd., BlackRock Asia-Pac Holdco, LLC, BlackRock HK Holdco Limited, BlackRock Cayco Limited, BlackRock Trident Holding Company Limited, BlackRock Japan Holdings GK, BlackRock Japan Co, Ltd.

3.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Holdco 4, LLC, BlackRock Holdco 6, LLC, BlackRock Delaware Holdings Inc, BlackRock Fund Advisors, BlackRock Institutional Trust Company, National Association.

4.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock, Inc Australia Holdco Pty. Ltd., BlackRock, Inc Investment Management (Australia) Limited.

5.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Group Limited, BlackRock Advisors (UK) Limited.

6.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Group Limited, BlackRock International Limited.

7.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Canada Holdings LP, BlackRock Canada Holdings ULC, BlackRock Asset Management Canada Limited.

8. - BlackRock, Inc, Trident Merger, LLC, BlackRock Investment Management, LLC.

9.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Holdco 4, LLC, BlackRock Holdco 6, LLC, BlackRock Delaware Holdings Inc., BlackRock Fund Advisors.

10.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd., BlackRock Asia-Pac Holdco, LLC, BlackRock HK Holdco Limited, BlackRock Asset Management North Asia Limited.

11.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Group Limited, BlackRock Investment Management (UK) Limited, BlackRock Asset Management Deutschland AG.

12.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Group Limited, BlackRock (Netherlands) B.V.

13. - BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc.

14.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd, BlackRock (Singapore) Limited.

15.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Capital Holdings, Inc, BlackRock Advisors, LLC.

Likewise, on January 30, 2017, Blackrock, Inc. informed to the Securities Exchange Commission that its shareholding on the share capital of Telefónica, S.A. was 6.7%.

- Note 2 to Section A.3.]

It should be noted that the Company has an Internal Code of Conduct for Securities Markets Issues setting out, among other issues, the general operating principles for Directors and senior executives when carrying out personal trades involving securities issued by Telefónica, S.A. and financial instruments and contracts whose underlying securities or instruments are issued by the Company. The Board of Directors on its meeting held on December 14, 2016, approved a new version of the Internal Code of Conduct in order to adapt it to the regulatory changes on this matter.

The general operating principles of this Internal Code of Conduct include transactions subject to notification, action limitations as well as the minimum holding period when acquiring securities in the Company, during which time these may not be transferred, except in the event of extraordinary situations that justify their transfer, subject to authorisation by the Regulatory Compliance Committee.

- Note 3 to Section A.3.]

The General Shareholders' Meeting on May 30, 2014, shareholders approved the introduction of a long-term incentive plan for managers of the Group (including Executive Directors), also known as the Performance & Investment Plan ("PIP"). Under this plan, participants who met the qualifying requirements were also awarded a certain number of Telefónica, S.A. shares as a form of variable remuneration. This General Shareholders' Meeting approved the maximum number of shares to be awarded to Executive Directors subject to their meeting the co-investment requirement established in the Plan and the maximum target total shareholder return (TSR) established for each phase.

In accordance with the above, the amounts appearing in Section A.3. of this report under "Number of direct votes" and "Equivalent number of shares" (i.e. Mr. José María Álvarez-Pallete López, 384,000-600,000 and Mr. César Alierta Izuel, 648,000-1,012,500) relate to the theoretical number of shares assigned and the maximum possible number of shares in the first and second phase of the Plan approved by the General Shareholders Meeting of 30 May 2014, if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met.

Regarding the third phase of this Plan (2016-2019), the Board of Directors of the Company, after a favourable report from the Nominating, Compensation and Corporate Governance Committee, agreed not to execute nor implement, it due to it was not aligned enough with the strategic plan of Group Telefónica, considering the circumstances and the macroeconomic environment.

- Note 4 to Section A.5.]

Until December 23, 2016, Telefónica Digital España, S.L.U. held a shareholding, together with CaixaBank Payments, Establecimiento Financiero de Crédito E.P., S.A.U., and Banco Santander, S.A., at Yaap Digital Services, S.L. On December 23, 2016, the liquidation deed for Yaap Digital Services, S.L. was granted.

- Note 5 to Section A.6.]

Shareholder Pact between Telefónica, S.A. – Vivendi, S.A.

In September 2015, after the regulatory approval from Conselho Administrativo de Defesa Econômica (CADE), Telefónica, S.A. delivered to Vivendi, S.A. 46.0 million of its treasury shares representing, in that moment, 0.95% of its share capital, in exchange for 58.4 million preference shares of Telefónica Brasil, S.A. (received by Vivendi, S.A. as part of the acquisition of GVT Participações, S.A.), accounting for approximately 3.5% of the share capital of Telefónica Brasil, S.A.

By virtue of this agreement, Vivendi, S.A. has agreed to a number of obligations, including the following: (i) to refrain from selling shares of Telefónica during certain periods (lock up), and (ii) accept certain restrictions which, in the event of transfer, once the lock up periods have elapsed, guarantee that such shares are sold in an orderly manner.

At the date of this Report, the shareholding of Vivendi on the share capital of Telefónica, S.A. is 0.978%.

Shareholder Pact between Telefónica, S.A. – China Unicom (Hong Kong) Limited

In accordance with the provisions of Article 112, Section 2 of the Securities Market Act 24/1988, of July 28 (currently replaced by Article 531 Section 1 of the revised text of the Spanish Corporations Act approved by Royal Decree Law 1/2010, of July 2), on October 22, 2009, the Company notified the Spanish Securities Market Commission (Comisión Nacional del Mercado de Valores, “CNMV”) that on September 6, 2009 Telefónica had entered into a mutual share exchange agreement with China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per Article 530 of the Spanish Corporations Act. By virtue of these clauses, Telefónica may not, while the strategic partnership agreement is in force, offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited. In addition, China Unicom (Hong Kong) Limited undertook not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica’s voting share capital (excluding intragroup transfers). This undertaking was rendered null and void when the aforementioned period of one year had elapsed.

At the same time, both parties also undertook similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited.

This mutual share exchange agreement, which includes the shareholder agreement, was filed with the Madrid Mercantile Registry on November 24, 2009.

On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited (“China Unicom”) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Through its subsidiary Telefónica Internacional, S.A.U., Telefónica acquired a number of China Unicom shares amounting to 500 million US dollars from third parties, within nine months of signature of this agreement. In recognition of China Unicom’s stake in Telefónica, the latter commits to proposing the appointment of a board member nominated by China Unicom in the next General Shareholders’ Meeting, in accordance with prevailing legislation and the Company’s By-laws. The General Shareholders’ Meeting held on May 18, 2011 duly approved the appointment of China Unicom’s nominee, Mr. Chang Xiaobing, as member of the Board of Directors.

China Unicom completed the acquisition of Telefónica shares on January 28, 2011, giving it ownership of 1.37% of the Company’s capital.

The Telefónica Group purchased China Unicom shares during 2011 to the amount of 358 million euros. At December 31, 2011, the Telefónica Group held a 9.57% stake in the company.

On June 10, 2012, Telefónica, S.A. through its wholly-owned subsidiary Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited, through a wholly-owned subsidiary, signed an agreement for the purchase by the latter of 1,073,777,121 shares in China Unicom (Hong Kong) Limited owned by Telefónica, equivalent to 4.56% of its capital.

After securing the requisite regulatory authorizations, the sales transaction was completed on July 30, 2012.

Subsequent to the transaction, Telefónica and China Unicom remained firmly committed to their Strategic Partnership.

Telefónica agreed not to sell the shares it holds directly and indirectly in China Unicom for a period of 12 months as from the date of the agreement.

On November 10, 2014 Telefónica sold 597,844,100 shares in China Unicom, representing 2.5% of the capital of the latter, in a block trade process, at a price of HK \$ 11.14 per share, in a total amount of HK \$ 6,660 million, approximately 687 million euros at exchange rates on that date.

Telefónica undertook not to sell any shares held directly or indirectly in China Unicom on the market for a period of 12 months from the selling date.

Likewise, on July 13, 2016, Telefónica through its 100% subsidiary, Telefónica Internacional, S.A.U. proceeded with the sale of 361,794,559 shares of China Unicom, representing 1.51% of the share capital of the company, by a block trade process, at a price of HK \$ 7.80 per share, for a total amount of HK \$ 2,822 million, approximately € 322 million,

Telefónica committed not to transfer to the market the shares of China Unicom, which it may own directly or indirectly, over a period of 90 days from the sales date.

Telefónica maintains its commitment to the Strategic Partnership with China Unicom, recently strengthened through cooperation in digital areas such as the big data joint venture between both companies.

- Note 6 to Section A.9.bis]

As stated in Section A.6 of this report, in September 2015, after the regulatory approval from Conselho Administrativo de Defesa Econômica (CADE), Telefónica, S.A. delivered to Vivendi 46.0 million of its treasury shares, representing, in that moment, 0.95% of its share capital, in exchange for 58.4 million preference shares of Telefónica Brasil, S.A. (received by Vivendi, S.A. as part of the acquisition of GVT Participações, S.A.), accounting for approximately 3.5% of the share capital of Telefónica Brasil, S.A.

By virtue of this agreement, Vivendi, S.A. has agreed to a number of obligations, including the following: (i) refrain from selling shares of Telefónica during certain periods (lock up), and (ii) accept certain restrictions which, in the event of transfer, once the lock up periods have elapsed, guarantee that such shares are sold in an orderly manner.

At the date of this Report, the shareholding of Vivendi on the share capital of Telefónica, S.A. is 0.978%.

However, the aforementioned percentage of 0.978% of share capital has not been included in the percentage of “estimated free-float capital” set out in section A.9.bis of this Report.

- Note 7 to Section A.10.]

In accordance with Article 26 of the Corporate By-laws, no shareholder may cast a number of votes in excess of 10% of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10% voting ceiling.

The limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

For the purposes of the provisions contained in the preceding paragraph, the provisions of Section 18 of the current Spanish Corporations Act shall apply in order to decide whether or not a group of entities exists and to examine the situations of control indicated above.

In relation to the above and in accordance with the provisions of Article 527 of the Spanish Corporations Act, any clauses in the By-laws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

- Note 8 to Section C.1.12.]

Mr. Isidro Fainé Casas was Chairman of Caixabank, S.A. until June 2016.

Mr. Peter Löscher is Chairman of the Supervisory Board of OMV Aktiengesellschaft and Chairman of Sulzer AG and member of the Supervisory Board of Deutsche Bank AG.

Mr. Antonio Massanell Lavilla is member of the Supervisory Board of Erste Group Bank AG.

Mr. Ignacio Moreno Martínez of Secuoya, Grupo de Comunicación, S.A., is the individual representing the Board member Cardomana Servicios y Gestiones, S.L.

- Note 9 to Section C.1.16.]

For these purposes, Senior Executives are understood to be individuals who perform senior management functions reporting directly to the management bodies, or their Executive Commissions or CEOs. For the purposes of annual remuneration, the head of Internal Audit is also included.

With effect from January 1, 2017, Mr. Mariano de Beer assumed the position of Chief Commercial Digital Officer (CCDO) of the Company, replacing Mr. Eduardo Navarro de Carvalho.

Mr. Juan Francisco Gallego Arrechea was appointed Director Internal Audit on May 2016, therefore, it is reflected the compensation received from that date. Until May 2016, the Director of Internal Audit was Mr. Ignacio Cuesta Marín-Gil, therefore, it is reflected the compensation received until that date.

It is included the compensation received by Mr. Santiago Fernández Valbuena as member of the Senior Executives, since his resignation as Director of the Company on April 8, 2016. It is noted that Mr. Santiago Fernández Valbuena received an amount of 10,560,000 euros in compensation as a result of his cessation as an Officer of Telefónica, S.A. in May 2016.

- Note 10 to Section C.1.17.]

Mr. Juan Ignacio Cirac Sasturain is member of the Scientific Advisory Committee of the Fundación Banco Bilbao Vizcaya Argentaria, and member of the Advisory Board of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa", to whom he advises as a Physic expert on their investigation activities, without receiving any compensation for such positions (except 1,000 euros as Attendance fees of each one of the meetings - three meetings per year - of the Advisory Board of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa").

Ms. Sabina Fluxà Thienemann is member of the Regional Advisory Board of the East (joining Valencia, Murcia and Baleares) of Banco Bilbao Vizcaya Argentaria, S.A., to whom she advises as prominent businesswoman on their objective to keep on approaching their business strategy to the current social-economic situation of such regions, without receiving any remuneration for such position.

- Note 11 to Section C.1.19.]

Selection and appointment

Telefónica's Bylaws state that the Board of Directors shall be composed of a minimum of five members and a maximum of twenty, to be appointed at the General Shareholders Meeting. Directors are appointed for a period of no longer than four years, and may be re-elected for one or more subsequent periods of no longer than four years at a time. The Board of Directors may, in accordance with the Spanish Corporations Act and the Company Bylaws, provisionally co-opt Directors to fill any vacancies.

The Board of Directors shall have the power to fill, on an interim basis, any vacancies that may occur therein, by appointing, in such manner as is legally allowed, the persons who are to fill such vacancies until the holding of the next General Shareholders Meeting.

Also, in all cases, proposed appointments of Directors must follow the procedures set out in the Company's Bylaws and Regulations of the Board of Directors and be preceded by the appropriate favourable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the Committee. Proposals for individuals to represent legal entities (companies) have to be made following a report by the Nominating, Compensation and Corporate Governance Committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must assess the skills, knowledge and experience required in the Board of Directors, defining the functions and abilities needed by candidates to cover each vacancy, and evaluating the time and dedication needed for them to efficiently perform their duties. It will also have to escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposed appointments of other Company Directors to the Board of Directors for appointment by co-option or for the design to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.

In line with the provisions of its Regulations, the Board of Directors, exercising the right to fill vacancies by interim appointment and to propose appointments to the shareholders at the General Shareholders Meeting, shall ensure that, in the composition of the Board of Directors, external or non-executive Directors represent an ample majority over executive Directors. Similarly, the Board shall ensure that the total number of independent Directors represents at least one third of the total number of Board members.

The nature of each Director shall be explained by the Board of Directors to the shareholders at the General Shareholders Meeting at which the appointment thereof must be made or ratified. Furthermore, such nature shall be reviewed annually by the Board after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

In any event, and in the event of re-election or ratification of Directors by the General Shareholders Meeting, the report of the Nominating, Compensation and Corporate Governance Committee, or, in the case of independent Directors, the proposal of said Committee, will contain an assessment of the work and effective time devoted to the post during the last period in which it was held by the proposed Director.

Both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that those proposed for the post of Director should be persons of recognised calibre, qualifications and experience, who are willing to devote the time and effort necessary to carrying out their functions, and shall take extreme care in the selection of persons to be appointed as independent Directors.

The Board of Directors will have to ensure that Board members are selected using procedures that guarantee gender equality and diversity of knowledge and experience, that prevent any underlying bias would could cause any kind of discrimination, and, in particular, that the procedures should favour the selection of female directors.

In its meeting on November 25, 2015, the Board of Directors approved a Director Selection Policy which is aimed at ensuring that appointment or re-election proposals meet the Board's requirements as set out in a preliminary analysis, encouraging gender equality and diversity of knowledge and experience, preventing any underlying bias would could cause any kind of discrimination. This Director Selection Policy is available on the Company's corporate website.

The result of the preliminary analysis of the needs of the Board of Directors will be set out in the report of the Nominating, Compensation and Corporate Governance Committee, which will be published on calling the General Shareholders Meeting at which each Director will be submitted for ratification, appointment or re-election.

Every year, the Nominating, Compensation and Corporate Governance Committee will check that the Director selection policy is complied with, and will report with such information in the Annual Corporate Governance Report.

Re-election

Directors can be re-elected once or several times for the same periods as the initial period.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Nominating, Compensation and Corporate Governance Committee, and in the case of independent Directors, by the corresponding proposal by the Committee.

Appraisal

In accordance with the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee has the powers to organise and coordinate, together with the Chairman of the Board of Directors, the regular assessment of said body, after which the Board of Directors approves the assessment of its function and the functioning of its Committees.

In accordance with the above, it should be noted that the Board of Directors and its Committees carry out a periodic evaluation of the operation of the Board of Directors and of the Committees thereof in order to determine the opinion of Directors regarding the workings of these bodies and to establish any proposals for improvements to ensure the optimum working of the company's governing bodies.

Removal and dismissal

Directors' shall cease to hold office when the term for which they were appointed expires, or when so resolved by the shareholders at the General Shareholders Meeting in the exercise of the powers legally granted to them.

Directors who give up their place before their tenure expires, should state their reasons in a letter to be sent to all members of the Board of Directors.

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board alter a report from the Nominating, Compensation and Corporate Governance Committee. Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

The removal of independent Directors may also be proposed as a result of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

- Note 12 to Section C.1.29]

The Board of Directors at its meeting held on April 27, 2016, on a favourable report from the Nominating, Compensation and Corporate Governance Committee, adopted a new setting for the Advisory or Control Committees of the Company in with regards to its organization, structure and composition in order to increase its efficiency and to optimize the administration of the corporate governance structure of Telefónica, S.A.

Within this context, the Board of Directors unanimously adopted the following resolutions: i) to reorganize the then-existing Regulation and Institutional Affairs Committees, which became a single Committee called the Regulation and Institutional Affairs Committee, the powers, duties and responsibilities of which are those that until such time corresponded to each of such Committees; and ii) to reorganize the then-existing Strategy and Innovation Committees, which became a single Committee called the Strategy and Innovation Committee, the powers, duties and responsibilities of which are those that until such time corresponded to each of such Committees.

Until April 27, 2016, Regulation Committee has met once, Institutional Affairs Committee has met 4 times, Strategy Committee has met 4 times and Innovation Committee has met 3 times.

- Note 13 to Section C.1.31.]

In accordance with US securities market regulations, the information contained in the Annual Report in 20-F format (which includes the Consolidated Financial Statements of the Telefónica Group), filed with the Securities and Exchange Commission, is certified by the Executive Chairman of the Company and by the CFO. This certification is made after the Financial Statements have been prepared by the Board of Directors of the Company.

- Note 14 to Section C.1.36.]

The Board of Directors of Telefónica, S.A. at its meeting held April 8, 2016, on a proposal from its Audit and Control Committee and as a result of a transparent competitive process, has resolved to propose to the next Ordinary General Shareholders Meeting the appointment of PricewaterhouseCoopers Auditores S.L. as statutory auditor for the Annual Accounts of Telefonica, S.A. and its Consolidated Group of Companies for the years 2017, 2018 and 2019. Such appointment was approved by the General Shareholders Meeting held on May 12, 2016.

- Note 15 to Section C.1.39.]

Financial year 1983 was the first audited by an External Auditor. Previously the financial statement were revised by chartered accountants (known at the time as "censores de cuentas"). Therefore, 1983 is the base year taken for calculating the percentage in the case of audits of the Financial Statements of Telefónica, S.A., while 1991 is the date taken for the calculation of the percentage in the case of the Consolidated Financial Statements, as 1991 was the first year in which the Telefónica Group prepared Consolidated Financial Statements.

- Note 16 to Section C.2.1]

The Board of Directors at its meeting held on April 27, 2016, on a favourable report from the Nominating, Compensation and Corporate Governance Committee, adopted a new setting for the Advisory or Control Committees of the Company in with regards to its organization, structure and composition in order to increase its efficiency and to optimize the administration of the corporate governance structure of Telefónica, S.A.

Within this context, the Board of Directors unanimously adopted the following resolutions: i) to reorganize the then-existing Regulation and Institutional Affairs Committees, which became a single Committee called the Regulation and Institutional Affairs Committee, the powers, duties and responsibilities of which are those that until such time corresponded to each of such Committees; and ii) to reorganize the then-existing Strategy and Innovation Committees, which became a single Committee called the Strategy and Innovation Committee, the powers, duties and responsibilities of which are those that until such time corresponded to each of such Committees.

- Note 17 to Section C.2.1]

Pursuant to the provisions of Article 39 of the Corporate Bylaws of Telefónica, S.A., Article 22 of the Regulations of the Board of Directors of the Company regulates the Audit and Control Committee in the following terms:

a) Composition.

The Audit and Control Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors, and most of them must be at least Independent Directors. When appointing its members, and, in particular, when appointing its Chairman, the Board of Directors shall take into account the appointees' knowledge and experience in matters of accounting, auditing or both, as well as in risk management. Overall, the members of the Committee will have the adequate technical knowledge in relation to the Company's sector of activity.

The Chairman of the Audit and Control Committee, who shall in all events be an independent Director, shall be appointed from among its members, and shall be replaced every four years; he may be re-elected after one year from the date when he ceased to hold office.

b) Duties.

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

1) Report to the General Shareholders Meeting regarding matters addressed in the Committee for which it is responsible, and, in particular, regarding the result of the audit, and explain how the audit has improved the integrity of the financial information and the function played by the Committee in this process.

2) Escalate proposals for selection, appointment, re-election and replacement of the external auditor to the Board of Directors, taking responsibility for the selection process as established in prevailing laws, as well as the recruitment conditions, and regularly gather information from the auditor about the audit plan and its execution, as well as safeguarding its independence in exercising its functions.

3) To supervise internal audit and, in particular:

- a) Ensure the independence and efficiency of the internal audit function;
- b) Propose the selection, appointment and removal of the person responsible for the internal audit;
- c) Propose the budget for such service;
- d) Review the annual internal audit work plan and the annual activities report;
- e) Receive periodic information on its activities; and
- f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.

4) Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.

5) Monitor the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal risks, and discuss with the Auditors significant weaknesses in the internal control system detected during the audit, without compromising their independence at any time. For that purposes, if deemed necessary, it can submit recommendations or proposals to the Board of Directors and an appropriate monitoring period. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:

- a) the types of risk (operational, technological, financial, legal and reputational) facing the company;

b) the risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialise; and

c) the control and information systems to be used to control and manage these risks.

6) Establish and supervise a system that allows employees to confidentially and anonymously report potentially significant irregularities, particularly any financial and accounting irregularities detected within the Company.

7) Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualised information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.

8) Issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in point 7) above, considered individual and in their entirety, other than legal audit, and in relation to the regime of independence or laws regulating auditing activities.

9) Analyse and report on economic conditions, the accounting impact, and, if applicable, the proposed exchange ratio in structural and corporate modification transactions which the Company intends to perform, before being submitted to the Board of Directors.

10) Preliminary reporting to the Board of Directors regarding all matters set out in prevailing legislation and in the Bylaws, and, in particular, concerning:

1. The financial information that the Company must periodically disclose;
2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and
3. Related party transactions.

11) Exercise all the pertinent functions of the Audit Committee established at any given time by prevailing laws in regard to Group companies which are considered to be Public Interest Entities (as these are defined in applicable laws), provided that they are fully owned, either directly or indirectly, by the Company pursuant to applicable laws, and whose administration is not attributed to a Board of Directors.

The dispositions of sections 2, 7 and 8 are understood to be without prejudice to general auditing regulations.

c) Operation.

The Audit and Control Committee shall meet at least once every quarter and as often as appropriate, when called by its Chairman.

In the performance of its duties, the Audit and Control Committee may require that the Company's Auditor and the person responsible for internal audit, and any employee or senior executive officer of the Company, attend its meetings.

Most significant actions during the year.

The main activities and actions carried out by the Audit and Control Committee of the Board of Directors of Telefónica, S.A. during 2016 concerned the powers and duties of the Committee, due to both legal requirements and also to the interest arising according to the nature of such powers. The Audit and Control Committee has analysed and reviewed a number of questions which include the following:

- In financial matters: i) review of the Company's financial reporting (2015 Annual Accounts and Management Reports, and the regular quarterly and half-yearly financial information), ii) review of prospectuses presented by the Company to different supervisory Bodies (which include the 20-F Financial Report and a number of Prospectuses for financing (shares and debt) arrangements), and iii) review of single-theme presentations on financial matters and changes in accounting standards.

- Regarding the external auditor: i) proposed appointment and fees to be received by Ernst & Young as Statutory Auditor for the year 2016, ii) review of audit tasks and limited reviews conducted by the external auditor with regard to the financial reporting referred to above; iii) selection process of the new Statutory Auditor of Telefónica, S.A. for the years 2017, 2018 and 2019, which concluded with the appointment of PricewaterCoopers (PwC) by the General Shareholders Meeting held on May 12, 2016, on a proposal from the Board of Directors, all in accordance with the Law 22/2015, of July 20, Audit of Accounts; and iv) selection process for the new Statutory Auditor for the Public Interest Entities for Group Telefónica (for the years 2017, 2018 and 2019), in respect of which the Audit and Control Committee of Telefónica, S.A. has assumed the functions of its respective Audit Committees (Telefónica de España, S.A.U., Telefónica Móviles España, S.A.U., Seguros de Vida y Pensiones Antares, S.A., Telefónica Emisiones, S.A.U., Telefónica Participaciones, S.A.U., and Telefónica Europe, B.V.).
- Regarding internal control: i) of cross-cutting processes, investigations and inspections, ii) risk management system, and iii) inspection, investigation and fraud tasks in the field of regulatory compliance, including anti-corruption rules.

Furthermore, regarding to the Director member of the Audit and Control Committee who has been appointed based on his knowledges and experience in accounting, audit or both, apart from Mr. José Javier Echenique Landiribar, the Directors Mr. Antonio Massanell Lavilla and Mr. Ignacio Moreno Martínez have been appointed.

- Note 18 to Section C.2.1.]

Pursuant to the provisions of Article 40 of the Corporate Bylaws of Telefónica, S.A., Article 23 of the Regulations of the Board of Directors of the Company regulates the Nominating, Compensation and Corporate Governance Committee in the following terms:

a) Composition.

The Nominating, Compensation and Corporate Governance Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors, and most of them must be at least Independent Directors.

The Chairman of the Nominating, Compensation and Corporate Governance Committee, who shall in all events be an Independent Director, shall be appointed from among its members.

b) Duties.

Notwithstanding other duties entrusted it by the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall have the following duties:

- 1) Assess the skills, knowledge and experience necessary in the Board of Directors. For these purposes, it will define the roles and capabilities required of the candidates to fill each vacancy, and assess the time and dedication necessary for them to efficiently perform their duties.
- 2) Set a target of representation for the least represented gender on the Board of Directors and provide guidelines about how this target might be reached.
- 3) Escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.
- 4) Submit proposed appointments of other Company Directors to the Board of Directors for appointment by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposals for appointments or termination of the Secretary, and, if applicable, of the Deputy Secretary of the Board of Directors, and also proposals for the appointment, re-election and termination of Directors in their subsidiary companies.
- 5) Report on proposals to appoint or to terminate the Senior Management of the Company and their subsidiaries.
- 6) To report on the proposals for appointment of the members of the Executive Commission and of the other Committees of the Board of Directors, as well as the respective Secretary and, if applicable, the respective Deputy Secretary.
- 7) To propose to the Board of Directors the appointment of the Lead Director from among the Independent Directors.

8) To organise and coordinate, together with the Chairman of the Board of Directors, a periodic assessment of the Board, pursuant to the provisions of these Regulations.

9) To inform on the periodic assessment of the performance of the Chairman of the Board of Directors.

10) To examine or organize the succession of the Chairman of the Board of Directors and, if applicable, to make proposals to the Board of Directors so that such succession occurs in an orderly and well-planned manner.

11) To propose to the Board of Directors, within the framework established in the Corporate Bylaws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 34 of the Regulations of the Board.

12) To propose to the Board of Directors, within the framework established in the Bylaws, the extent and amount of the compensation, rights and remuneration of a financial nature of the Chairman of the Board of Directors, the Executive Directors and the senior executives of the Company, as well as the basic terms of their contracts, for purposes of contractual implementation thereof.

13) To prepare and propose to the Board of Directors an annual report regarding the Directors' compensation policy.

14) To verify information on the remuneration of Directors and senior management contained in the various corporate documents, including the annual report on Directors' remuneration.

15) To supervise compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.

16) To exercise other powers assigned to the Nominating, Compensation and Corporate Governance Committee in this Regulation.

c) Operation.

In addition to the meetings provided for in the annual schedule, the Nominating, Compensation and Corporate Governance Committee shall meet whenever the Board of Directors of the Company or the Chairman of the Board of Directors requests the issuance of a report or the making of a proposal within the scope of its powers and duties, provided that, in the opinion of the Chairman of the Committee, it is appropriate for the proper implementation of its duties.

The Nominating, Compensation and Corporate Governance Committee will consult with the Chairman of the Board of Directors particularly when concerning matters relating to executive directors and senior officers.

Most significant actions during the year.

The main activities and actions carried out by the Nominating, Compensation and Corporate Governance Committee of the Board of Directors of Telefónica, S.A. during 2016 concerned the powers and duties of the Committee, due to both legal requirements and also to the interest of the matter arising in each case in accordance with such powers. The Nominating, Compensation and Corporate Governance Committee has analysed and informed a number of questions which include the following:

- The policy and remuneration system for Directors and Executives of the Telefónica Group (fixed and variable remuneration, and action plans).
- Proposed appointments relating to the Board of Directors of Telefónica, S.A. and its Committees, and to the Boards of its Subsidiaries.

In this respect, in the year 2016, the Nominating, Compensation and Corporate Governance Committee proposed and informed about the appointment of the Directors of Telefónica, S.A., based on solvency, competence, experience, professional merits and willingness of the appointees to devote the time and effort needed for the effective performance of their functions, and only when considering their personal and professional features.

Consequently, on its meeting held on April 7, 2016, the Committee proposed to the Company's Board of Directors, the appointment by co-optation of Ms. Sabina Fluxà Thienemann, Mr. José Javier Echenique Landiribar, Mr. Peter Löscher and Mr. Juan Ignacio Cirac Sacurain as independent Directors, replacing Mr. Carlos Colomer Casellas, Mr. Alfonso Ferrari Herrero, Mr. José Fernando de Almansa Moreno-Barreda and Mr. Santiago Fernández Valbuena.

Likewise, the Committee informed and/or proposed the re-election and ratification of the directors of Telefónica, S.A. by the General Ordinary Shareholders Meeting of the Company, considering and analysing

the functions performed and the commitment of the Directors, basing all the proposals on a prior analysis of the Board of Directors' needs, and promoting the knowledge, experience and gender diversity.

Thus, the General Ordinary Shareholders Meeting held on May 12, 2016, approved the re-election of Mr. Isidro Fainé Casas, Mr. Julio Linares López, Mr. Peter Erskine, and Mr. Antonio Massanell Lavilla, as well as the ratification of the appointment by co-optation of Ms. Sabina Fluxà Thienemann, Mr. José Javier Echenique Landiribar, Mr. Peter Löscher, Mr. Juan Ignacio Cirac Sasturain, and Mr. Wang Xiaochu.

Furthermore, on its meeting held on April 7, 2016, the Committee informed and presented to the Board of Directors its proposal to appoint Mr. José María Álvarez-Pallete López as Executive Chairman, replacing Mr. César Alierta Izuel, who was the Executive Chairman.

Likewise, the Committee on such meeting of April 7, 2016, proposed to appointment Mr. Francisco Javier de Paz Mancho as Lead Director, replacing Mr. Alfonso Ferrari Herrero.

Besides, the Committee analysed the proposal regarding the new setting of the Advisory and Control Committees which support the Board of Directors of the Company, with regard to its organization, structure and composition in order to reach the greater efficiency possible and to optimize the administration of the corporate governance structure of Telefónica, S.A.

Additionally, the Committee informed during the meetings held about several appointment proposals of Directors in the main Subsidiary Companies of Group Telefónica.

- Proposed modifications in the organisational structure of the Telefónica Group.
- 2015 Corporate Governance Report and Remuneration Report.

- Note 19 to Section C. 2.2.]

The presence of women in the extinct Regulatory, Institutional Affairs, Strategy and Innovation Committees, while were operational, were the following:

- Regulation Committee:
2016 Year: 1(16.67%), 2015 Year: 1(16.67%), 2014 Year: 1(16.67%), 2013 Year: 1(14.29%).
- Affairs Institutionals Committee:
2016 Year: 0, 2015 Year: 0, 2014 Year: 0, 2013 Year: 0.
- Strategy Committee:
2016 Year: 1(16.67%), 2015 Year: 1(16.67%), 2014 Year: 1(16.67%), 2013 Year: 1(16.67%).
- Innovation Committee:
2016 Year: 0, 2015 Year: 0, 2014 Year: 0, 2013 Year: 0.

- Note 20 to Section D. 2.]

It is important to note that:

Transactions included in this section under 'Other', amounting to 14,923 with BBVA, S.A. refer to Dividends received.

Transactions included in this section under 'Other', for the sum of 544,596 with BBVA, S.A. refer to Other Revenues (10,664), to Outstanding factoring operations (533,037), to Other Transactions (7), to Other Expenses (881) and to Gains from derecognition or disposal of assets (7).

Transactions included in this section under 'Other', for the sum of 250,031 with "la Caixa" Group, refer to Other Expenses (31) and Outstanding factoring operations (250,000)

In addition, the nominal value of outstanding derivatives held with BBVA and la Caixa in 2016 amounted to 18,047 and 392 million euros, respectively. As explained in Derivatives policy in Note 16 of the 2016 Consolidated Annual Accounts, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of

a single underlying. The fair value of these same derivatives in the statement of financial position is 988 and -35 million euros, respectively, in 2016. Additionally, at December 31, 2016 there were collateral guarantees on derivatives with BBVA amounting to 240 million euros.

- Note 21 to Section D.5.]

On December 18, 2015, a joint venture was set up between China Unicom for the development of Big Data services in China, using Smart Steps technology developed by Telefónica. Telefónica has a stake of 45% through Telefónica Digital España, S.L.; China Unicom Broadband Online Limited Corp. owns the remaining 55%. In 2016, Telefónica disbursed 7 million euros corresponding to its shareholding in the capital of the company. The company is already commercially operational and obtained a turnover of 4 million euros.

It is also stated that certain Telefónica Group subsidiaries carried out in the 2016 financial year, with the Inditex Group, operations derived from the Group's ordinary traffic or business related to telecommunications and related services, amounting to 36 million euros.

Finally, it should be said that as of the year 2010, Telefónica, S.A. adheres to the Code of Good Fiscal Practices, as approved by the Large Companies' Forum –a body in which major Spanish companies and the Spanish tax authorities participate–, and complies with the content of the same.

Similarly, Telefónica Group is committed to the application of other international regulations and initiatives in the area of sustainability as well as, among others, the Universal Declaration of Human Rights, the United Nations Global Compact, and other conventions and treaties agreed by international bodies such as the Organization for Economic Cooperation and Development and the International Labor Organization.

This annual corporate governance report was approved by the company's Board of Directors at its meeting held on February 22, 2017.

List whether any directors voted against or abstained from voting on the approval of this report.

No

Name or corporate name of director	Reasons (voted against, abstention, non-attendance)	Explain the reasons
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APPENDIX TO THE TELEFÓNICA, S.A. 2016 ANNUAL CORPORATE GOVERNANCE REPORT

E.3 Indicate the main risks, including tax risks, which may prevent the company from achieving its targets.

The Telefónica Group's business is affected by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position, reputation, corporate image and brand and its results of operations, must be considered jointly with the information in the Consolidated Financial Statements, and are as follows:

Group-Related Risks

Worsening of the economic and political environment could negatively affect Telefónica's business.

Telefónica's international presence enables the diversification of its activities across countries and regions, but it exposes Telefónica to various legislation, as well as to the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in this regard, including exchange-rate or sovereign-risk fluctuations, may adversely affect the Company's business, financial position, cash flows and results of operations and/or the performance of some or all of the Group's financial indicators.

Economic conditions may adversely affect the level of demand of existing and prospective customers, as they may no longer deem critical the services offered by the Group.

Growth in Europe and financial stability may be affected by political uncertainty in some European countries due to upcoming general elections, a possible revival of the crisis in Greece, restructuring of the banking sector and due to the impact of steps taken towards an EU banking union and a capital markets union. In particular, the British exit process from the European Union following the vote to leave in the recent referendum, will require an adjustment of the economy to whatever new trade and investment relationships are put in place in the future, with the consequences in the meantime being uncertainty regarding investment, activity and financial market volatility. In 2016, the Telefónica Group obtained 24.5% of its revenues in Spain (22.6% in 2015), 14.4% in Germany (the same percentage as in 2015) and 13.2% in United Kingdom (14.3% in 2015).

In Latin America, there is an increasing exchange rate risk brought on by external factors such as increasing interest rates in the United States amid still low commodity prices and doubts about growth and imbalances in China; as well as internal factors as a consequence of the still high fiscal and external deficits in the most important Latin American countries or the low liquidity in exchange markets as it is the case in Argentina.

Some of the most significant macroeconomic risk factors in the region affect Mexico, as it is the country with the highest commercial and financial exposure to the United States. In this sense, increasing interest rates and the possible overhaul of trade agreements between both countries could imply higher restrictions on imports into the United States that would affect negatively the economic activity in Mexico.

Brazil is undertaking several measures principally focused on adjusting its public finances. A constitutional amendment limiting public spending has been approved and the government has submitted a new social security reform bill to Congress. However, the possibility of a new bout of political turmoil, which could weaken the support of the reforms, is not negligible. While signs of stabilization have emerged, economic growth continues to be negative and the unemployment rate has hit double digits, having a sizable effect on consumption spending. Moreover, despite financing external needs have decreased, internal needs are still high. All these elements have led to new downgrades to the country's credit rating during 2016, which now is below investment grade.

In countries such as Chile, Colombia and Peru, the recent uptick in commodity prices is having a positive impact on its fiscal and external accounts, but growth continues to be below its potential level due to the lower external inflows, which have affected investment and, to a lower extent, consumption.

In Argentina, the new government is focused on resolving Argentina's macroeconomic and financial imbalances and on recovering international confidence. Although reforms taking place may have positive effects in the medium term, short term risks persist, including exchange rate risk, especially due to the high inflation rate amid an economic contraction.

During 2016, Telefónica Hispanoamérica represented 24.2% of the Telefónica Group's revenues (26.2% in 2015), of which 23.8% proceeded from revenues in Argentina, 19.9% in Peru and 17.2% in Chile. During 2016, Telefónica Brazil

represented 21.3% of the Telefónica's Group revenues (20.1% in 2015). In this respect, approximately 30.4% of the Group's revenues were generated in countries that do not have investment grade status (in order of importance, Brazil, Argentina, Ecuador, Nicaragua, Venezuela, Guatemala, Costa Rica and El Salvador), and other countries are only one notch away from losing this threshold.

"Country risk" factors include the following, among others:

- unexpected adverse changes in regulation or administrative policies, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approval);
- abrupt exchange rate movements;
- high inflation rates;
- expropriation or nationalization of assets, adverse tax decisions, or other forms of state intervention;
- economic-financial downturns, political instability and civil disturbances; and
- maximum limits on profit margins imposed in order to limit the prices of goods and services through the analysis of cost structures (for example, in Venezuela, a maximum profit margin has been introduced that is set annually by the Superintendence for Defense of Socioeconomic Rights).

Any of the foregoing may adversely affect the business, financial position, results of operations and cash flows of the Group.

The Group's financial condition and results of operations may be adversely affected if it does not effectively manage its exposure to foreign currency exchange rates or interest rates.

At December 31, 2016, 50.8% of the Group's net debt (in nominal terms) was pegged to fixed interest rates for over a year, while 20% was denominated in a currency other than the euro. At December 31, 2016, the net financial debt ratio in Latin American currencies was 13%.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2016: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 232 million euros for the year ended December 31, 2016, (ii) whereas a 100 basis points decrease in interest rates in all currencies (even if negative interest rates are reached), would lead to a reduction in financial expenses of 201 million euros for the year ended December 31, 2016. These calculations were made assuming a constant currency and balance position equivalent to the position at year end taking into account the derivative financial instruments arranged.

According to the Group's calculations, the impact on results arising from a 10% depreciation of Latin American currencies against the US dollar and a 10% depreciation of other global currencies against the euro, excluding the pound sterling, would result in exchange losses of 43 million euros for the year ended December 31, 2016, primarily due to the depreciation of the Venezuelan bolívar and, to a lesser extent, the Argentinean peso. These calculations were made assuming a constant currency financial position with an impact on profit or loss for the year ended December 31, 2016, including derivative instruments in place.

During 2016, Telefónica Brazil represented 24.6% (27.0% in 2015), Telefónica Hispanoamérica represented 23.0% (32.9% in 2015) and Telefónica United Kingdom represented 11.3% (14.6% in 2015) of the operating income before depreciation and amortization (OIBDA) of the Telefónica Group.

The Telefónica Group uses a variety of strategies to manage this risk, among others the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. However, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

Existing or worsening conditions in the financial markets may limit the Group's ability to finance, and consequently, the ability to carry out its business plan.

The performance, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the implementation of Telefónica's strategic plan and new technologies, the renewal of licenses or the expansion of the Telefónica Group's business in countries where it operates, may require a substantial amount of financing.

A decrease in the liquidity of Telefónica, a difficulty in refinancing maturing debt or raising new funds as debt or equity could force Telefónica to use resources allocated to investments or other commitments to pay its financial debt, which could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

Funding could be more difficult and costly in the event of a significant deterioration of conditions in the international or local financial markets due to the uncertainties regarding the hikes in interest rates on the part of the US Federal Reserve and the oil prices instabilities, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

At December 31, 2016, gross financial debt scheduled to mature in 2017 amounted to 13,326 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2018 amounted to 7,195 million euros.

In accordance with its liquidity policy, Telefónica has covered its gross debt maturities over the next twelve months with cash and credit lines available at December 31, 2016. Telefónica's liquidity could be affected if market conditions make it difficult to renew existing undrawn credit lines, 8% of which, at December 31, 2016, were scheduled to mature prior to December 31, 2017.

In addition, given the interrelation between economic growth and financial stability, the materialization of any of the economic, political and exchange rate risks referred to above could lead to a negative impact on the availability and cost of Telefónica's financing and its liquidity strategy, which could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

Adoption of new accounting standards could affect reported results and financial position.

Accounting Standardization Bodies and other authorities may periodically change accounting regulations that govern the preparation of the Group's consolidated financial statements. Those changes could have a significant impact on the way the Group accounts and presents its financial position and its operating income. In some instances, a modified standard or a new requirement with retroactive nature must be implemented, which requires the Group to restate previous financial statements.

See details of the implementation of new standards and interpretations issued in Note 3 of the Consolidated Financial Statements. In particular, Telefónica is required to adopt the new accounting standards IFRS15 Revenue from Contracts with Customers, effective from January 1, 2018, and IFRS 16 Leases, effective for the financial years from January 1, 2019. These standards present significant changes that could affect both the amount and moment of recognition of revenues and expenses related with certain sales transactions, as well as the accounting treatment for all lease contracts (other than short-term leases and leases of low-value assets). These changes could have a material impact on the Group's financial statements. Such impact is under analysis as of the date of this document.

Risks relating to the Group's Industry

The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.

The telecommunications sector is subject to laws and sector-specific regulations in the majority of the countries where the Group provides its services. Additionally, many of the services the Group provides require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to the acquisition of spectrum. Among the main risks of this nature are those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality. The fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations.

Thus, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies' decisions, such as economic fines for serious breaches in the provision of services and, potentially, revocation or failure to renew these licenses, authorizations or concessions, or the granting of new licenses to competitors for the provisions of services in a specific market.

In this regard, the Telefónica Group pursues its license renewals on the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality, service and coverage standards and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession.

Additionally, the Telefónica Group could be affected by regulatory actions carried out by the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses. Regarding the merger of Telefónica Deutschland Holding AG and E-Plus, other providers such as United Internet and the regional cable operator Airdata lodged an appeal before the General Court against the decision of the EU which authorized such merger. Telefónica Deutschland has been accepted as an interested party of the process and it has presented its statements in both cases. United Internet has lodged a second appeal against the EC in relation to the content of the letter of commitment assumed by Telefónica Deutschland regarding the implementation of remedies for non-network operators. In December 2016, each of Mass Response Service GmbH and Multiconnect GmbH filed an appeal before the General Court against the decision of the EU that Telefónica Deutschland is not obliged to grant access to Full-Mobile Virtual Network Operators ("MVNO") under the non-MNO remedy of the commitments. Telefónica Deutschland will apply for leave to intervene as an interested party.

Regulation of spectrum and access to new government licenses/concessions of spectrum

On September 14, 2016, the EC adopted, among other texts, a proposed Directive for the establishment of a European Electronic Communication Code, which could have significant implications, inter alia, for access to networks, spectrum use, auction conditions, duration and renewal of licenses, universal service, consumer protection, audiovisual services and platforms. It is estimated that the approval of such regulatory framework will take place in a year and a half.

On December 14, 2016, the European Parliament and Council agreed on a decision regarding the use and availability of the 700 MHz band. This could require new cash outflows from Telefónica between 2017 and 2022 in both the United Kingdom and Spain, where it is expected that the 700 MHz band will be available between 2020-2022. In connection with spectrum auctions for 2.3 and 3.4 GHz band, in the United Kingdom, Ofcom issued a consultation document on November 21, 2016. Responses were due by January 30, 2017, and a decision is expected in the second quarter of 2017. In Germany, the regulatory agency for electricity, gas, telecommunications, post and railway ("BNetzA") initiated a proceeding for the demand-oriented allocation of new frequencies for the further rollout of digital 5G infrastructures, which include the timely allocation of the 2 GHz spectrum expiring at the end of 2020 and 2025 (so called UMTS spectrum) and further spectrum (inter alia 3.5 GHz). A decision about the allocation procedure is expected towards the end of 2017 and an auction may take place in 2018 or 2019.

In Latin America, spectrum auctions are expected to take place requiring potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2017-2018, in the relevant jurisdiction for the Group, are:

- Mexico: An auction spectrum in the 2500 MHz band is expected to take place between the third quarter of 2017 and the second quarter of 2018. A wholesale network tender, which will offer services in the 700 MHz band was concluded on November 17, 2016. Altán was the tender winner and the commercial operations must begin no later than March 31, 2018.
- Colombia: During 2017 the Ministry of Information Technologies and Communications published for commentaries until March 7, 2017 the project of resolution with the conditions for an auction of 70 MHz of spectrum band in 700 MHz and 5 MHz in 1900 MHz. In addition, the Ministry published a project of decree increasing the spectrum cap for lower bands to 45 MHz and 90 MHz for upper bands. The schedule for the auction has not been set yet.
- Argentina: The Government instructed the regulatory authority to issue new regulations during 2017 to ensure the reassignment of frequencies of the radio spectrum for the provision of wireless or fixed wireless services and enables the reassignment of frequencies previously granted to other provider.

However, it is likely that some of these spectrum tender procedures will not be completed, or even initiated in the mentioned dates. In addition to the above, it may be the case that certain administrations may not yet have announced their intention to release new spectrum but may do so during 2017. The above does not include processes announced via general statements by administrations, which involve bands not key to Telefónica's needs. Furthermore, Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

Risks relating to concessions and licenses previously granted

The terms of concessions and licenses granted to the Group and necessary for the provision of its services may be challenged or amended by the regulators at any time, which may materially adversely affect its business, financial condition, results of operations and cash flows.

The German regulator initiated consultations in March and July 2016 on the frequency distribution after the merger between Telefónica Deutschland and E-Plus, particularly in the 2 GHz band and on the future spectrum allocation for 5G band. The result of such consultations could lead, among others, to proposals by the regulator reorganizing the spectrum that Telefónica Deutschland holds on the 2 GHz band.

In the United Kingdom, Telefónica has an obligation in its 800 MHz spectrum license to provide indoor coverage to 98% of the United Kingdom population (and 95% of the population of each of England, Wales, Scotland and Northern Ireland) and an obligation in its 900/1800 MHz spectrum license to provide voice and text services to 90% of the United Kingdom landmass, both by the end of 2017, to be maintained, thereafter. Inherent with these obligations is a risk of Telefónica United Kingdom not meeting the required targets. Telefónica United Kingdom is actively working towards mitigating the risk through the continuous investment in an infrastructure improvement program, upgrading its 2G and 3G Networks and continued roll-out of its 4G Network.

In the state of São Paulo, Telefônica Brazil provides local and national long-distance Fixed Switched Telephony Service ("STFC") under the so-called public regime, through a concession agreement, which is expected to remain in force until 2025. In accordance with current regulations, Telefônica Brasil informed the Brazilian regulatory authority (Agencia Nacional de Telecomunicações or "ANATEL") that the net value, as of December 31, 2015, of assets assigned to the provision of STFC (which include, among others, switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment) were estimated to total 7.8 billion Brazilian reais. At December 31, 2016, this value is estimated to total 8,813,916 Brazilian reais (this value will be updated in the second half of 2017). In principle, the assets assigned to the provision of STFC were considered reversible assets. During the last months, a bill amending the regulatory framework in Brazil has been processed, establishing, among others, that such assets will no longer be reversible under the new licenses regime in exchange for significant broadband investment commitments. Recently, the processing at the Senate of such bill has been challenged before the Federal Supreme Court. Such Court and, consequently, the Senate's governing board has decided to send the bill for voting in the plenary. With the bill being sent to the plenary, it could be understood that there is no more dispute for the Supreme Court to decide upon. In case that the bill is finally approved, ANATEL will be entitled to adopt the pertinent administrative decisions for the transformation of the respective licenses with the consequent modification of the future binding obligations to STFC providers.

In Colombia, the Ministry of Information Technologies and Communications ("ITC") issued Resolution 597 on March 27, 2014, to renew 850 MHz/1900 MHz licenses for 10 additional years. However, the reversion of assets (other than radio frequencies, which it is clear that must be returned) and its scope was widely discussed between the relevant mobile operators (including Telefónica Colombia) and the ITC in the context of the liquidation of the previous concession contract, taking into consideration the terms of the contract, and the Constitutional Court's interpretation of Law 422 of 1998 and Law 1341 of 2009. Discussions on the matter concluded on February 16, 2016, when the ITC convened an arbitration proceeding, in accordance with in the terms of the relevant concession contract. The relevant concession holders (including Telefónica Colombia) filed a response to the claim prompted by the ITC. The arbitration process is still ongoing.

In Peru, Telefónica has concessions for the provision of the fixed-line service until November 2027. In December 2013, Telefónica filed a partial renewal request for these concessions for five more years. In December 2014 and June 2016, Telefónica also filed a renewal request for twenty more years in relation to a concession for the provision of local carrier service and one of the concessions to provide mobile-line services in provinces, respectively. As of the date of this document, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) in all such proceedings is still pending and according to the legislation, the concessions subject of these procedures remain in force as long as the procedures are in progress.

Telefónica Móviles Chile, S.A. was awarded 2x10 MHz spectrum on the 700 MHz band in March 2014. A claim was brought by a consumer organization against the 700 MHz assignments. The decision by the Supreme Court on the appeal presented by such consumer organization is still pending.

During the year ended December 31, 2016, the Group's consolidated investment in spectrum acquisitions and renewals amounted to 345 million euros.

The Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above or any others in which it operates, or its inability to assume the related costs, could have an adverse impact on its ability to launch and provide new services and on Telefónica's ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and cash flows.

Regulation of wholesale and retail charges

The European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. From June 15, 2017, operators may not charge roaming users within the EU an additional fee on their domestic prices for roaming calls, SMS and data services. However, in some circumstances, operators may apply consumption limits and additional surcharge under a "fair use policy". In January 2017, wholesale roaming caps have been agreed between the Council and the Parliament and the maximum wholesale caps have been set at the following limits: 0.01€/sms; 0.032€/minute; data services glide path: 7.7€/GB (June - December 2017); 6€/GB (2018); 4.5€/GB (2019); 3.5€/GB (2020); 3€/GB (2021) and 2.5€/GB (2022).

On September 14, 2016, the EC presented its proposal of the regulatory framework which, among other measures, intends to incorporate a European methodology and a European upper limit for the call-termination prices for landline phone/ mobile phone applicable in EU.

The decreases in wholesale mobile termination rates ("MTR") in Europe are also noteworthy. In the United Kingdom, the current rate is 0.503 ppm. A further cut to 0.495 ppm will come into effect from April 1, 2017.

In Germany, on August 30, 2016, BNetzA adopted a regulatory decision, which considers with pure long run incremental cost ("LRIC") a new cost model for the calculation of MTR. Telefónica Deutschland has appealed the decision in court, but the appeal has not yet been decided. BNetzA approved new MTR on November 30, 2016, in a provisional decision, which sets the rates to 0.011 euro/minute as of December 1, 2016, to 0.0107 euro/minute as of December 1, 2017, and to 0.0095 euro/minute as of December 1, 2018, until the end of November 2019. Before taking a final decision, the new MTR are nationally consulted and notified to the EC. There is consequently a risk that when the new MTR are approved (which will be retroactively enforceable from December 1, 2016), and with the new termination rates applicable from January 1, 2017, the rates will significantly decrease. Regarding fixed networks termination rates, BNetzA adopted at the end of January 2017 a provisional decision which establish a tariff of 0.0010 euro/minute.

In Spain, on July 1, 2016, the Spanish National Regulatory and Competition Authority (Comisión Nacional de los Mercados y la Competencia or "CNMC") initiated the process of reviewing the prices of mobile termination, with a final decision expected to be adopted during 2017.

Additionally, on January 17, 2017, the CNMC issued the analysis of the market for access and call origination on fixed networks. The CNMC maintains the obligation of Telefónica, as an operator with significant market power, to provide a wholesale interconnection offer and a wholesale line rental ("WLR"), both with cost-oriented prices regarding manufacturing costs and the adoption of a management accounting system. Telefónica is equally obliged to non-discrimination, transparency and separation of accounts. In Latin America, it is likely that MTRs will also be reduced in the short to medium term.

In Brazil, ANATEL has issued ex-ante regulations to ensure competition in the wholesale market, which includes reductions of the MTR. In this regard, the Plano Geral de Metas de Competição ("PGMC"), amended by Resolution 649/2015, established that mobile termination fees are subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees are expected to be in force (such Resolution has been challenged in courts without a definitive outcome). On December 5, 2016, ANATEL issued a public consultation for the revision of the PGMC, which addresses changes in the relevant wholesale markets regulated by the PGMC and also in the cost-oriented model. The mentioned public consultation is available for comments until March 22, 2017.

In Mexico, on September 23, 2016, the Instituto Federal de Telecomunicaciones ("IFT") announced that the MTRs applicable to operators different from the so-called Prevailing Economic Agent for 2017 will be 0.1906 pesos per minute, as long as the regulatory asymmetry of the Prevailing Economic Agent introduced by Mexico with the constitutional reform on 2014 and the new Federal Telecommunication Law on 2014 remains in effect.

In Colombia, the Comisión de Regulación de Comunicaciones ("CRC") published a regulatory project for public comments in November 2016. In the project the CRC proposes a symmetric termination rate of 11.17 COP per minute and 4.3 million COP per monthly capacity from 2017 for established operators and an asymmetric termination rate of 19.01 COP per minute and 7.6 million COP per monthly capacity for challenger operators in a five-year period. The CRC also proposes regulatory measures to promote the entry of mobile virtual network operators ("MVNOs"), including the regulation of prices for the access to the mobile networks. The project is still in debate.

In Peru, the Organismo Supervisor de las Telecomunicaciones ("OSIPTEL") started the process for the revision of the values on charges of interconnection for mobile termination of calls in telecommunication services networks in November 2016. The new values established by OSIPTEL will apply as of the fourth quarter of 2017.

As a result of the foregoing regulatory actions, Telefónica may receive lower prices for certain of its services, which may materially adversely affect its business, financial condition, results of operations and cash flows.

Regulation of Universal Services

The Universal Service ("US") is an economic and legal term which refers to the obligation imposed to telecommunication operators to provide a basic service to all inhabitants of a country. In general, the goal is to promote quality services availability at affordable, reasonable and fair prices, to increase the access to advanced telecommunication services (such as broadband) and to move forward with the availability of such services to all customers. On its reform proposal for the regulatory framework issued on September 14, 2016, the EC seeks to modernize the Universal Services area in Europe, removing the mandatory inclusion of the traditional services (telephone boxes, directories and information services) and focusing on the provision of affordable broadband services. The EC also proposed that the US must be funded from general budgets and not from sectorial budgets. However, if this funding method does not thrive, the affordable broadband inclusion could result more expensive for the sector. In any case, it is estimated that the new regulation will not be applicable before 2020.

In Spain, the licenses of Telefónica de España and Telefónica Telecomunicaciones Públicas for the provision of USs expired on December 31, 2016. Both companies have been designated for the provision of these services from January 1, 2017.

In Brazil, on December 15, 2016, a proposal of the General Plan for Universalisation of Fixed Switched Telephony Services ("PGMU") was approved by ANATEL.

The imposition on the Telefónica Group of additional or more onerous obligations to provide US services in the jurisdictions where it operates could have a material adverse effect on its business, financial condition, results of operations and cash flows.

Regulation of fiber networks

On February 24, 2016, the Spanish CNMC adopted a final resolution on the wholesale broadband market regulation, which raises a geographical segmentation in competitive (66 cities, 34% of total population) and non-competitive areas. It is anticipated that this resolution will last for at least four years. Its implementation is expected to result in a moderate increase of the current regulatory obligations of Telefónica in Spain, in terms of its granting of access to other operators to its fiber network and with respect to certain aspects relating specifically to the business segment (high quality bitstream service for business customers with national coverage). This Resolution has been appealed by Telefónica España. Additionally, on January 18, 2016, the CNMC adopted a resolution which approves the reference offer of the new wholesale unbundled virtual access service to Telefónica's new broadband Ethernet service (local NEBA). The NEBA service should be operative in 12 months from the date of the resolution's adoption.

Any of such obligations and restrictions could raise costs and limit Telefónica's freedom to provide the mentioned services, which could materially adversely affect Telefónica's business, financial condition, results of operations and cash flows.

Regulations on privacy

An intense data protection and privacy regulation may result in limitations to offer innovative digital services such as Big Data services. In Europe the new General Data Protection Regulation ("GDPR") of April 27, 2016, will be directly applicable in all member States from May 25, 2018. The GDPR introduces administrative fines of up to 4% of an undertaking's annual global turnover for breaching the new data protection rules.

On January 10, 2017, the EC presented its proposal for a regulation on ePrivacy, which will replace the current Directive 2002/58/EC on privacy in the electronic communications sector and will complement the recently approved GDPR. The proposal also introduces administrative fines of up to 4% of an undertaking's annual global turnover for breaching new regulations.

In October 2015, the Court of Justice of the European Union declared invalid the decision of the EC as regards the "Safe Harbor Agreement" relating to the transfer of personal data from the EU to the United States. Subsequently, the EC adopted a new decision on Privacy Shield on July 12, 2016, which considers that there is an adequate level of protection of personal data transferred from the EU to US self-certified companies complying with the Privacy Shield principles. Telefónica USA, Inc. has self-certified itself as Privacy Shield compliant. The Privacy Shield has been challenged before the EU's General Court by civil-society groups, but the admission of their appeals is still pending.

In Brazil, the adoption of a Personal Data Protection Act is still pending, this could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment.

Any of such obligations and restrictions could raise costs and limit Telefónica's ability to provide certain services, which could materially adversely affect Telefónica's business, financial condition, results of operations and cash flows.

Regulation of network neutrality

Under the principle of network neutrality applicable to Internet access services area, network operators could not establish technical or commercial restrictions regarding the terminals that can be connected or the services, or applications and contents that can be accessed or distributed through the Internet by the end user. It also refers to the non-discriminatory behaviour (e.g. non-anticompetitive) to be adopted by operators regarding the different types of Internet traffic circulating through their networks.

In Europe, the application of the so-called "net neutrality Regulation" (Regulation (EU) 2015/2120 of November 25, 2015) will be monitored by national regulatory authorities following guidance to be delivered by the European Regulatory Authority ("BEREC") on August 30, 2016. This guidance could directly impact internet access service commercial practices (for example, some zero rating offers) and it may limit network management practices or increase transparency requirements on the Internet Access Service.

Telefónica operates in Latin American countries where net neutrality is being implemented, such as Chile, Colombia, Mexico and Peru, where OSIPTEL adopted regulations aimed at providing clear guidelines on the implementation of the net neutrality regime adopted in 2012 and in force since January 1, 2017. In Brazil, the President approved a net neutrality decree (regulating Marco Civil) on May 11, 2016. In Mexico, the IFT scheduled a public consultation to be carried out in August 2016 in respect of the guidelines that will be issued regarding net neutrality, which was postponed to the first quarter 2017. In Chile, on November 22, 2016, the Commission of Telecommunications submitted a bill for amending the Network Neutrality Act. The main changes are the establishment of rules more restricted to apply measures for traffic management and restrictive rules for "Zero Rating". If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to various anti-corruption laws, including the US Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanctions programs, including those administered by the United Nations, the European Union and the United States, including the US Treasury Department's Office of Foreign Assets Control. The anti-corruption laws generally prohibit providing anything of value to government officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group's business, it may deal with entities, the employees of which are considered government officials. In addition, economic sanctions programs restrict the Group's business dealings with certain sanctioned countries, individuals and entities.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption laws and sanctions regulations could lead to financial penalties, exclusion from government contracts, damage to the Group's reputation and other consequences that could have a material adverse effect on the Group's business, results of operations and financial condition.

Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about these matters and intends to cooperate with those authorities as the investigations continue. It is not possible at this time to predict the scope or duration of these matters or their likely outcome.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

Telefónica may not be able to adequately foresee and respond to technological changes and sector trends.

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

New products and technologies arise constantly, and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 906 million euros in 2016, representing a decrease of 14.1% from 1,055 million euros in 2015 (1,111 million euros in 2014). These expenses represented 1.7%, 1.9% and 2.2% of the Group's consolidated revenues in 2016, 2015 and 2014, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development ("OECD") manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 300MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond to Telefónica's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency. Any failure by the Telefónica Group's IT systems to adequately respond to the Group's evolving operating requirements could have an adverse effect on the Group's business, financial condition and results of operations.

Telefónica depends on its suppliers.

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets, with a high concentration in a small number of suppliers, poses risks that may affect Telefónica's operations, and may cause legal contingencies or damages to its image in the event that inappropriate practices are produced by a participant in the supply chain.

As of December 31, 2016, the Telefónica Group depended on three handset suppliers and 12 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

Unanticipated network interruptions can lead to quality loss or the interruption of the service.

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs,

penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses become increasingly dependent on telecommunications and computer networks and adopt cloud computing technologies. Cybersecurity threats include gaining unauthorized access to Telefónica's systems or inserting computer viruses or malicious software in its systems to misappropriate consumer data and other sensitive information, corrupt Telefónica's data or disrupt its operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, portable data devices and mobile phones and intelligence gathering on employees with access.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to Telefónica being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may adversely affect the business, financial conditions, results of operations and cash flows of the Telefónica Group.

Possible regulatory, business, economic or political changes could lead to asset impairment.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairments in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. In 2016, impairment losses in goodwill were recognized amounting to 215 million euros for Telefónica operations in Venezuela (124 million euros) and Mexico (91 million euros).

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

Any of the foregoing could have an adverse effect on the business, financial position, results of operations and cash flows of the Group.

Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings.

Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and cash flows. In particular, the Telefónica Group is party to certain judicial tax proceedings in Peru concerning the clearance of certain previous years' income tax, in respect of which a contentious-administrative appeal is currently pending and to certain tax proceedings in Brazil, primarily relating to the ICMS (a Brazilian tax on telecommunication services) and to the Corporate Tax. Further details on these matters are provided in Notes 17 and 21 of the Consolidated Financial Statements.

Translation of an independent assurance's report on the Internal Control over Financial Reporting originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails

INDEPENDENT ASSURANCE'S REPORT ON THE INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)

To the Board of Directors of
Telefónica, S.A., engaged by the management

Scope of the Work

We have examined the description of the Internal Control over Financial Reporting (ICFR or "System") of Telefónica, S.A. (the Parent Company) and subsidiaries (the Group) contained in Section F of the Annual Corporate Governance Report for the year ended December 31, 2016.

The objective of this System is to contribute to the transactions performed being presented fairly under the aforementioned accounting framework and to provide reasonable assurance in relation to the prevention or detection of any errors that might have a material effect on the consolidated financial statements.

The aforementioned System is based on the rules and policies defined by Group management in accordance with the guidelines established by the *Committee of Sponsoring Organizations of the Treadway Commission (COSO)* in its report "*Internal Control - Integrated Framework*" (2013).

A system of internal control over financial reporting is a process designed to provide reasonable assurance on the reliability of financial information in accordance with the accounting principles and standards applicable to it. A system of internal control over financial reporting includes policies and procedures that: (i) enable the records reflecting the transactions performed to be kept accurately and with a reasonable level of detail; (ii) guarantee that these transactions are performed only in accordance with the authorizations established; (iii) provide reasonable assurance as the proper recognition of transaction to make it possible to prepare the financial information in accordance with the accounting principles and standards applicable to it; and (iv) provide reasonable assurance in relation to the prevention or timely detection of unauthorized acquisitions, uses or sales of Group assets which could have a material effect on the financial information. In view of the limitation inherent to any system of internal control over financial reporting, certain errors, irregularities of fraud may not be detected. Also, the projection to future periods of an evaluation of internal control is subject to risks, including the risk that internal control may be rendered inadequate as a result of future changes in the applicable conditions or that there may be a reduction in the future of the degree of compliance with the policies or procedures established.

Directors' Responsibility

The Board of Directors of Telefónica, S.A. is responsible for maintaining internal control over the financial reporting included in the consolidated financial statements and for assessing its effectiveness.

Our Responsibility

Our responsibility is to express an opinion on the effectiveness of the Internal Control over the Financial Reporting (ICFR), based on the work performed by us and the obtainment of sufficient evidences.

Our work includes an assessment of the effectiveness of the internal control over financial reporting in relation to the financial information contained in the Group's consolidated financial statements as at December 31, 2016, prepared in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the regulatory financial reporting framework applicable to the Telefónica Group in Spain.

Our work was performed in accordance with the requirements established in Standard ISAE 3000 "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" issued by the International Auditing Standards Board (IAASB) of the International Federation of Accountants (IFAC) for the issuance of reasonable assurance reports.

The work performed to obtain reasonable assurance includes obtaining an understanding of the internal control over financial reporting with respect to the financial information included in the consolidated financial statements, assessing the risk that a material weakness exists, testing and evaluation the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Independence

Our work was performed in accordance with the independence standards required by the Code of Ethics of the International Ethics Standards Board of Accountants (IESBA), which are based on the fundamental principles of integrity, objectivity, professional competence, due care, confidentiality and professional behaviour.

In accordance with International Standard on Quality Control (ISQC) 1, our Firm has in place a global system of quality control which includes documented policies and procedures in relation to compliance with ethical requirements, professional standards and applicable legislation.

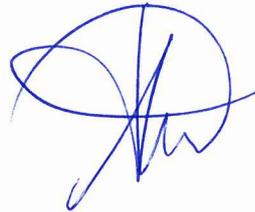
Conclusion

In our opinion, Telefónica, S.A. and subsidiaries maintained, in all material respects, an effective internal control with respect to the financial information contained in the consolidated financial statements as of December 31, 2016, based on the criteria and policies defined by the Board of Directors of Telefónica, S.A. in accordance with the guidelines established by the *Committee of Organizations of the Treadway Commission (COSO)* in its report "*Internal Control-Integrated Framework*"(2013). Furthermore, the disclosures contained in the information relating to the system of ICFR which is included in Note F of the Telefónica Group's Annual Corporate Governance Report at December 31, 2016 are in compliance, in all material respects, with the requirements established by the Spanish Companies Law, the Order ECC/461/2013, of 20 March and Circular 7/2015, of 22 December, as amended by the Spanish Securities Market Commission Circular 5/2013, of 12 June.

Other matters

The examination indicated in the preceding paragraphs is not subject to the Spanish Audit Law, so we do not express an audit opinion in the terms provided for in the aforementioned Law. Notwithstanding, we have audited, in accordance with prevailing audit regulations in Spain, the consolidated financial statements of Telefónica, S.A. and subsidiaries at December 31, 2016, prepared by the Parent Company's Directors in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group in Spain, and our report dated February 23, 2017 expressed an unqualified opinion on the aforementioned consolidated financial statements.

ERNST & YOUNG, S.L.



Alicia Martínez Durán

February 23, 2017