

***REPORT ON THE OPERATION OF THE  
NOMINATING, COMPENSATION AND CORPORATE  
GOVERNANCE COMMITTEE OF THE BOARD OF  
DIRECTORS OF TELEFÓNICA, S.A. FOR FISCAL YEAR  
2018***

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FISCAL YEAR 2018**

**I. INTRODUCTION.**

The Nominating, Compensation and Corporate Governance Committee was created as the Selection and Remuneration Committee in 1997 by the Board of Directors of Telefónica, S.A., in order to analyze and examine issues relating to the proposed appointments and removals of Directors and Senior Executive Officers of the Telefónica Group, and its remuneration system.

Also, as a result of the amendment made to the Regulations of the Company's Board of Directors to adapt them to the Olivencia Report, on July 22, 1998 the Committee changed its name to the Appointments and Remuneration Committee, as well as changing its powers and duties.

Similarly, and pursuant to the resolution adopted by the Board of Directors at its meeting of June 26, 2002, the Committee was renamed the Nominating and Compensation and Corporate Governance Committee and was assigned new duties in the area of Good Corporate Governance practices and recommendations. The subsequent amendment of the Regulations of the Board of Directors pursuant to a resolution of the Board at its meeting of November 28, 2007 introduced a technical improvement to the name of the Committee, which became the Nominating, Compensation and Corporate Governance Committee.

After the resolution of the shareholders at the General Shareholders' Meeting of the Company held on May 31, 2013, the rules applicable to this Committee were set forth in Article 40 of the By-Laws, having previously only been included in the Regulations of the Board of Directors.

Finally, after the resolution of the shareholders at the General Shareholders' Meeting held on June 12, 2015 pursuant to which the By-Laws and the Regulations for the General Shareholders' Meeting of the Company were amended, at its meeting of November 25, 2015 the Board of Directors approved the corresponding amendment of its Regulations primarily in order to adapt their content to the By-Laws and the Regulations for the General Shareholders' Meeting, and with particular regard to the Nominating, Compensation and Corporate Governance Committee, to adapt them to Section 529 *quindecies* of the Companies Act (*Ley de Sociedades de Capital*) and to Recommendations 48 and 50 of the Good Governance Code of Listed Companies.

## II. POWERS AND DUTIES OF THE COMMITTEE.

The powers and duties of the Nominating, Compensation and Corporate Governance Committee are established in the aforementioned Article 40 of the By-Laws and Article 23 of the Regulations of the Board of Directors.

Pursuant to the provisions of the aforementioned Article 23 of the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee of Telefónica, S.A. is assigned the following powers and duties, without prejudice to any other tasks that the Board of Directors may entrust thereto:

- 1) To evaluate the skills, knowledge and experience necessary within the Board of Directors. For such purposes, it shall determine the functions and aptitudes needed in the candidates who must fill each vacancy and shall evaluate the time and dedication required for them to effectively carry out their tasks.
- 2) To establish a goal for representation by the less represented gender on the Board of Directors and prepare guidance on how to achieve this objective.
- 3) To submit proposed appointments of independent Directors to the Board of Directors for their appointment on an interim basis to fill a vacancy or for submission of such proposals to a decision by the shareholders at the General Shareholders' Meeting, as well as proposals for re-election or removal of such Directors by the shareholders at the General Shareholders' Meeting.
- 4) To report on the proposed appointments of the other Directors of the Company for their appointment on an interim basis to fill a vacancy or for submission of such proposals to a decision by the shareholders at the General Shareholders' Meeting, as well as proposals for the re-election or removal thereof by the shareholders at the General Shareholders' Meeting. To also report on proposals for the appointment and removal of the Secretary and any Deputy Secretary of the Board of Directors of the Company, as well as proposals for the appointment, re-election and removal of Directors from the subsidiaries thereof.
- 5) To report on the proposals for the appointment and removal of the Senior Executive Officers of the Company and its 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 of 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) Together with the Chairman of the Board of Directors, to organize and coordinate a periodic assessment of the Board of Directors pursuant to the Regulations of the Board of Directors.

- 9) To report on the periodic evaluation 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 planned manner.
- 11) To propose to the Board of Directors, within the framework established in the By-Laws, 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 By-Laws, the extent and amount of the compensation, rights and remuneration of a financial nature, of the Chairman of the Board of Directors, of the Executive Directors and the Senior Executive Officers 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 Director remuneration policy.
- 14) To verify the information regarding the compensation of the Directors and Senior Executive Officers set forth in the various corporate documents, including the annual report on the Director remuneration policy.
- 15) To supervise compliance with the Company's internal codes of conduct and the corporate governance rules thereof in effect from time to time.
- 16) To exercise such other powers and perform such other duties as are assigned to the Nominating, Compensation and Corporate Governance Committee in the Regulations of the Board of Directors.

### **III. COMPOSITION OF THE COMMITTEE.**

As regards its composition, in accordance with the provisions of Article 23 of the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall consist of not less than three Directors, appointed by the Board of Directors. All members of such Committee must be external Directors, and the majority of them must be independent Directors.

The same article also provides that the Chairman of this Committee shall, in all events, be an independent Director.

The composition of the Nominating, Compensation and Corporate Governance Committee as of December 31, 2018 was as follows (with no change through the date of issuance of this Report):

<b>Director</b>	<b>Position</b>	<b>Category</b>	<b>Date of appointment</b>
Mr. Francisco Javier de Paz Mancho	Chairman	Independent	04-08-2016
Mr. José Javier Echenique Landiribar	Member	Independent	05-04-2017
Mr. Peter Erskine	Member	Other External	02-27-2008
Ms. Sabina Fluxà Thienemann	Member	Independent	04-27-2016
Mr. Luiz Fernando Furlán	Member	Independent	05-04-2017

It should also be noted that on April 8, 2016, the Chairman of the Committee, Mr. Francisco Javier de Paz Mancho, was appointed as Lead Director by resolution of the Board of Directors of the Company.

The Secretary of the Nominating, Compensation and Corporate Governance Committee is Mr. Pablo de Carvajal González, General Counsel and Global Director of Regulatory Affairs of Telefónica, S.A.

#### **IV. OPERATION OF THE COMMITTEE.**

The Nominating, Compensation and Corporate Governance Committee meets as often as it deems appropriate to analyze matters within its purview (in most cases, prior to a meeting of Telefónica's Board of Directors), upon a call by the Chairman of the Committee.

The Nominating, Compensation and Corporate Governance Committee held 11 meetings during 2018.

These meetings lasted for an average of approximately two hours each, with the Committee members dedicating an appropriate number of hours to the study and analysis of the matters to be addressed.

Attendance is individually monitored for each Committee member at the commencement of each meeting and recorded in the corresponding Minutes.

The various matters submitted for deliberation and, where appropriate, decision-making, are addressed in due detail at all meetings of the Committee. The members thereof actively participate in the various debates and discussions, stating their opinions when they deem it appropriate.

The deliberations of the Committee and the resolutions and decisions that it adopts are recorded in the corresponding Minutes of each meeting, which are drafted by the

Secretary of said Committee after the conclusion thereof and distributed to the Committee members for approval and comments. The Minutes are subsequently submitted for approval as the first item on the Agenda of the next Committee meeting and are signed by the Secretary with the approval of the Chairman.

As with the other Committees of the Board, relations between the Nominating, Compensation and Corporate Governance Committee and the Board of Directors are based on the principle of full transparency. In this regard, the Chairman of the Committee reports to the Board at each of its monthly meetings and at the beginning of the Board of Directors' meeting regarding the main issues discussed and the activities and work performed by the Committee, even making the relevant documentation available to the Board of Directors so that it is made aware of such actions for the exercise of its powers.

The Nominating, Compensation and Corporate Governance Committee is validly in session when at least half of the members are present, in person or by proxy, and resolutions are adopted by simple majority of those present. In the event of a tie, the Chairman has a tie-breaking vote.

#### **V. ATTENDANCE AT MEETINGS OF THE COMMITTEE.**

As regards attendees, in addition to the Committee members, the meetings of this Committee are customarily attended by members of Telefónica, S.A.'s management team, who, due to the powers and duties assigned thereto, can provide support and assistance to Committee members on the issues that are analyzed at each of its meetings. Committee meetings are customarily attended by the Global Director of Human Resources and the Director of Compensation and Benefits of Telefónica, S.A.

#### **VI. ISSUES EXAMINED BY THE COMMITTEE DURING 2018.**

Among the issues that the Committee examined at its meetings held in 2018, some concern its established duties and others relate to the interest they garner in light of the powers assigned to the Committee.

In the examination and debate of the issues addressed by this Committee during fiscal year 2018, the speakers accompanied their statements with presentations and/or reports, with the following main issues having been analyzed, discussed and reviewed:

##### ***1. Proposed appointments relating to the Board and its Committees, and the Boards of Subsidiaries.***

In accordance with the powers assigned thereto, the Committee has proposed or reported favorably, as applicable, on the proposed appointments, re-elections and ratifications of Directors of Telefónica, S.A. that were submitted to the Board of Directors, and subsequently to the shareholders at the General Shareholders'

Meeting. In general, the proposals were based on a prior analysis of the needs of the Company's Board of Directors and on favoring a diversity of expertise, professional training and experience, age and gender therein, without any implicit bias that could entail any discrimination, particularly on the grounds of gender, disability or any other personal condition; all of the foregoing is pursuant to the provisions of the Diversity and Director Selection Policy in relation to the Board of Directors of Telefónica, S.A.. For such purpose, the reputation, competence, experience, professional merit and willingness of candidates to devote the time and effort required for the effective performance of their roles were taken into consideration, also taking into account their personal and professional characteristics and, in the case of re-election, evaluating their previous roles performed and dedication provided.

In addition, over the course of its meetings the Committee has reported on various proposals for appointment of Directors at decision-making bodies of Subsidiaries or Affiliates of the Telefónica Group.

2. *Proposed appointments related to Senior Executive Officers and the organizational structure of the Telefónica Group.*

The Committee also analyzed and made a favorable report on proposals related to the appointment of Senior Executive Officers of the Company and of its Subsidiaries, analyzing the proposed appointments and the suitability and professionalism of the candidates, together with their curricula and their career within and outside the Company.

The Committee also analyzed changes to the organizational structure of the Telefónica Group, as well as other workforce-related issues such as diversity and various policies applicable to Officers and employees.

3. *Remuneration policy and regime for the Directors, Senior Executive Officers and Employees of the Telefónica Group (fixed and variable remuneration and shares deadlines).*

With respect to the remuneration regime for Directors and Executive Officers, at its various meetings the Committee reviewed the current remuneration of the Board of Directors as well as the remuneration of the Company's Executive Officers and other issues relating to the remuneration regime thereof.

In particular, the Committee presented to the Company's Board of Directors, for submission to the shareholders at the Ordinary General Shareholders' Meeting, the proposed Director Remuneration Policy of Telefónica, S.A. for the three-year period 2019-2021. Such Remuneration Policy was approved by the shareholders at the Company's General Shareholders' Meeting held on June 8, 2018.



#### 4. *Telefónica, S.A. Share Plans.*

- In connection with the implementation of the Second Cycle (2015-2018) of the Performance & Investment Plan (PIP) approved by the shareholders at the General Shareholders' Meeting on May 30, 2014, and which ended on September 30, 2018, the Committee examined and reported favorably on the proposal regarding the non-delivery of the shares for such Second Cycle, considering that the conditions established in the aforementioned Plan had not been met.
- The Committee also reviewed and evaluated the proposal from the Human Resources Directorate of Telefónica, S.A. regarding the new 2018-2020 Long-Term Incentive Plan for Officers of the Group and the Executive Directors of Telefónica. Such Plan was approved by the shareholders at the Company's General Shareholders' Meeting held on June 8, 2018.
- Furthermore, the Committee reviewed and evaluated the proposal from the Human Resources Directorate of Telefónica, S.A. regarding the Global Plan for the incentive purchase of shares of Telefónica, S.A. for the Employees of the Telefónica Group, including Officers of the Group and the Executive Directors of Telefónica. Such Plan was approved by the shareholders at the Company's General Shareholders' Meeting held on June 8, 2018.

#### 5. *Other issues analyzed:*

##### ➤ *Evaluation of the Board, its Committees and the General Meeting*

The Committee reviewed and analyzed the results of the evaluation of the Company's Board of Directors for fiscal year 2017 prepared by the external advisor Villafañe & Asociados Consultores, regarding the operation of the Board of Directors and its Committees and of the General Shareholders' Meeting of the Company. The results from such external evaluation were satisfactory, including some very positive aspects of the Company's corporate governance system, although there were some proposed improvements.

Furthermore, as to the evaluation of the Company's Board of Directors for fiscal year 2018, at the meeting of the Board of Directors held on December 12, 2018, a questionnaire was delivered to all of the Directors in order to perform the evaluation for that year.

The results of this evaluation process were examined and analyzed by the Nominating, Compensation and Corporate Governance Committee at its meeting held on January and February 2019. The Committee concluded that in general terms, the Directors reported a high degree of satisfaction with the organization

and activities of the governance bodies, but identified certain proposed improvements.

➤ *Annual Corporate Governance Report.*

The Committee reviewed and reported favorably on the content of the Annual Corporate Governance Report of Telefónica, S.A. for fiscal year 2017, which was subsequently approved by the Company's Board of Directors and then by the shareholders at the General Shareholders' Meeting.

Pursuant to the provisions of the Regulations of the Board of Directors, the Committee also verified the classification of each of the Directors of the Company.

➤ *Annual Report on Director Remuneration.*

The Committee also analyzed and reported favorably on the Director Remuneration Report for 2017, which was then approved by the Company's Board of Directors for submission to a consultative vote of the shareholders at the General Shareholders' Meeting.

➤ *Proposals for the appointment of Board Members at the subsidiary companies of the Telefónica Group.*

## **VII. CONCLUSIONS AND FORECASTS FOR FISCAL YEAR 2019.**

As reflected above, over the course of fiscal year 2018 the Nominating, Compensation and Corporate Governance Committee has analyzed the main issues and aspects within its purview, regularly reporting to the Company's Board of Directors on the most significant issues.

In fiscal year 2019, this Committee expects to continue with the review and supervision of all matters within its purview, and particularly to analyze and examine the issues relating to Corporate Governance, remuneration policy and the organizational structure of the Senior Executive Officers of the Telefónica Group.

In this regard, the Committee has established an Activity Plan for 2019, which sets out on a monthly basis all the activities that the Committee must perform during the fiscal year, planning the actions thereof in its various fields of activity.

Madrid, January 2019

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