

***FUNCTIONING AND REPORT OF ACTIVITIES OF THE  
NOMINATING, COMPENSATION AND CORPORATE  
GOVERNANCE COMMITTEE OF THE BOARD OF  
DIRECTORS OF TELEFÓNICA, S.A.***

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# ***NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE OF THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A.***

## **I. INTRODUCTION**

The purpose of the present document is to describe the functioning of the Nominating, Compensation and Corporate Governance Committee of Telefónica, S.A. (henceforth, the Company), sketching out, likewise, aspects related to its duties, remit and membership.

The Nominating, Compensation and Corporate Governance Committee was created in 1997 by the Board of Directors of Telefónica, S.A., under the title of Selection and Compensation Committee, for the purpose of analyzing and examining questions relating to proposed appointments and removals of Directors and Senior Managers of Telefónica Group, and their Compensation scheme.

Similarly, and as a consequence of the modifications to the Regulations of the Board of Directors of the Company to adapt them to the Olivencia Report, the Committee changed its name to the Nominating and Compensation Committee on 22 July 1998, in addition to changing its duties and remit.

Likewise, and pursuant to the resolution adopted by the Board of Directors on 26 June 2002, the Committee came to be called the Nominating and Compensation and Corporate Governance Committee, with new duties relating to practices and recommendations for Corporate Governance being assigned. Afterwards, among the amendments to the Regulations of the Board of Directors approved by the same at its meeting on 28 November 2007, there was a minor improvement in the name, which became the Nominating, Compensation and Corporate Governance Committee.

After the resolution by the General Shareholders' Meeting of the Company held on 31 May 2013, the regime applicable to this Committee was set out in article 40 of the Company Bylaws, which was established until then, in the Regulations of the Board of Directors.

Finally, after the resolution issued on 12 June 2015 by the General Shareholders' Meeting of the Company, by which the By-laws and Regulations of the General Shareholders Meeting were amended, the Board of Directors approved, on 25 November 2015, the amendment of its Regulations pursuant to adapt its content to the By-laws and the Regulations of the General Shareholders' Meeting, particularly, with regard to the Nominating, Compensation and Governance Committee, to the article of 529 quincecies of the Act 31/2014, of 3 December, amending the Spanish Corporation Act for the improvement of the Good

Corporate Governance, and the recommendation 48 and 50 of the Good Corporate Governance Code for Listed Companies.

## **II. DUTIES AND POWERS OF THE COMMITTEE**

The duties and remit of the Nominating, Compensation and Corporate Governance Committee are laid down in the cited article 40 of the Company Bylaws and article 23 of the Regulations of the Board of Directors.

Thus, and pursuant to the cited article 23 of the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee of Telefónica S.A. has the following remit assigned, notwithstanding any other matter that may be entrusted to it by the Board of Directors:

- 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 reach this objective.
- 3) To submit proposed appointments of Independent Directors to the Board of Directors for 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 of such Directors by the shareholders at the General Shareholders' Meeting.
- 4) To submit proposed appointments of the other Directors of the Company for 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 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 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 these Regulations.
- 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 these Regulations of the Board of Directors.
- 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, 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 compensation 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 compensation policy.
- 15) To supervise compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.

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

With respect to its composition, and in accordance with article 23 of the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee must be made up of a minimum of three Directors, designated by the Board of Directors. All members of the Committee must be External Directors, and the majority must be Independent Directors.

The said article also sets out that the Chairman of this Committee shall always be an Independent Director.

On 31 December 2015, the composition of the Nominating, Compensation and Governance Committee was as follows:

- Mr. Alfonso Ferrari Herrero  
(Chairman)
- Mr. Carlos Colomer Casellas
- Mr. Peter Erskine
- Mr. Gonzalo Hinojosa Fernández de Angulo
- Mr. Pablo Isla Álvarez de Tejera

The professional profiles of the members of the Nominating, Compensation and Corporate Governance Committee are publicly available at the Corporate website of Telefónica, S.A.

[http://www.telefonica.com/es/shareholdersinvestors/html/corporate\\_governance/compcionsejo.shtml](http://www.telefonica.com/es/shareholdersinvestors/html/corporate_governance/compcionsejo.shtml)

It should be said that on 31 May 2013, the Chairman of the Committee. Mr. Alfonso Ferrari Herrero, was designated Lead Independent Director of the Company, by resolution of the Board of Directors.

The Secretary to the Committee is the General and Board Secretary of Telefónica, S.A., Mr. Ramiro Sánchez de Lerín García-Ovies, who advises on all juridical matters related to this Committee, supported by the Group Vicesecretary and Chief Legal Officer of the Group, Ms. María Luz Medrano Aranguren, and the Corporate Governance and Securities Market Director, Ms. Consuelo Barbé Capdevila.

#### **IV. FUNCTIONING OF THE COMMITTEE**

The Nominating, Compensation and Corporate Governance Committee meets as often as is deemed fit to analyze the issues which fall within its purview (in most cases, before the meetings of the Board of Directors of Telefónica), subject to prior convocation by the Chairman of the Committee.

In 2015, the Nominating, Compensation and Corporate Governance Committee has held 11 meetings.

These meetings have lasted around two hours on average, dedicating its members an appropriate numbers of hours to the study and analysis of the issues to be discussed.

In the matter of attendance, each member of the Committee is subject to attendance control, a record being taken at the start of each session, and

recorded in the corresponding Minutes. In 2015, all the members of the Committee have attended, present or represented, to all the meetings.

All meetings of the Committee discuss the different questions submitted for deliberation, or for decision where appropriate, in the due depth. The members intervene actively in the different debates and discussions, giving their opinion whenever they should see fit.

The deliberations of the Committee and the agreements and decisions adopted are documented in the corresponding Minutes for each session, written by the Secretary of the Committee at the end of the session and later distributed to all members for their assent and observations. Finally, the Minutes are submitted for approval as the first point on the Agenda for the following meeting of the Committee, and they are then signed by the Secretary and with the approval of the Chairman.

As is the case with the other Committees of the Board, the relations between the Nominating, Compensation and Corporate Governance Committee and the Board of Directors are based on a principle of full transparency. In fact, the Chairman of the Committee gives an account to the Board, at each of its monthly meetings, and at the start of the Board session, of the main issues discussed and the activities and work carried out by the Committee, even putting the corresponding documentation at its disposal, so that the Board is aware of these actions for the exercise of its competences.

The sessions of the Nominating, Compensation and Corporate Governance Committee are quorate when at least half of the members are present, directly or by proxy, and resolutions are adopted by simple majority of those present. In the event of a tie, the Chairman holds a casting vote.

## **V. ATTENDANCE AT MEETINGS**

Regarding those who attend the meetings of this Committee apart from its own members, the sessions are generally attended by different members of the management team of Telefónica S.A. who, because of their duties and remit, can engage in support and assistance to Committee members in the matters to be analyzed at the meeting. Principally, the Corporate Human Resources Director of Telefónica, S.A., and the Compensation Director of Telefónica, S.A.

## **VI. MATTERS DISCUSSED BY THE NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE IN 2015.**

Among the matters that the Committee analyzed in 2015, some corresponded to its duties and others prompted the interest of the Committee because of their relation to its competences.

In the examination and debate of the issues discussed by the Committee during the financial year 2015, the speakers accompanied their points with presentations and/or reports, analyzing and discussing, among other matters, the following:

*1. Proposed appointments relating to the Board and its Committees, and the Boards of Affiliate Companies.*

In accordance with the remit assigned, the Committee, throughout the sessions held, analysed and issued favourable opinion on the nomination of a Director to the Board of Telefónica, S.A., and various proposals to appoint Directors to the Board of its Affiliate Companies.

*2. Proposed appointments related to Senior Managers and organizational changes.*

Similarly, the Committee analyzed and issued favourable opinion about those proposals related to the appointment of Senior Management of the Company and its Affiliate Companies, appraising the proposed appointments and the fit and professionalism of the candidates, together with their curricula and their career within and beyond the Company.

*3. Remunerative regime for the Directors, Senior Managers and Employees of Telefónica Group.*

With respect to Compensation for Directors and senior managers, the Nominating, Compensation and Corporate Governance Committee studied the regime currently in place for the same at the Company.

*4. Telefónica, S.A. Share Plans*

On the Second Cycle of the Long Term Incentives Plan (2012-2015) approved by the General Meeting of Shareholders on 18 May 2011, designed for Telefónica Group Directors, including Executive Directors of Telefónica, S.A. -the Performance & Investment Plan ("PIP")- the Committee on Appointments, Remuneration and Good Governance studied and issued a favourable report on the number of shares to be awarded to each of the Plan's beneficiaries.

Equally, and as regards the Second Cycle of the Long Term Incentives Plan (2015-2018) approved by the General Meeting of Shareholders on 30 May 2014, designed for Telefónica Group Directors, including Executive Directors of Telefónica, S.A. -the Performance & Investment Plan ("PIP")- the Committee on Appointments, Remuneration and Good Governance studied and issued a favourable report on: i) the definitive criteria applicable to the awarding of shares in the Plan's Second Cycle, and according to which the specific awards for each beneficiary of the Cycle are to be made; ii) the maximum amount to be used for the Plan's Second Cycle, which is within the upper limit set for the entire duration of the Plan up to the end of the Second Cycle, and iii) the maximum number of shares to be perceived at the end of the Second Cycle, all in accordance with the decisions of the General Meeting of Company Shareholders held on 30 May 2014, including the maximum number of theoretical shares to be awarded, and



the maximum possible number of shares that can be received by Telefónica, S.A. Executive Directors and Senior Directors, in the event they meet the co-investment requirement laid down in said Plan and if they fully comply with the Total Shareholder Return (“TSR”) goal set for the Second Cycle.

Furthermore, the Nominating, Compensation and Governance Committee reviewed and studied the proposal from the Telefónica, S.A. Human Resources Department regarding various aspects of the Telefónica, S.A. Global Share Purchase Incentive Plan for Telefónica Group employees, backed by the Group's commitment to award free of charge a number of additional shares in Telefónica, S.A. to those who sign up to the Plan, so long as certain pre-requisites are met.

#### *5. Amendment of the Rules of Procedure of the Board of Directors.*

At its meeting on 24 of November 2015, the Committee studied and issued a favourable opinion of the proposed amendment to the Regulations of the Board of Directors of Telefónica, S.A. As outline above, such modification was framed within the proposals submitted for revision of the By-laws and the Regulations of the General Shareholders Meeting, approved by the General Shareholders Meeting on 12 June 2015, pursuant to reflect the abovementioned amendments as well as to adapt to the legal amendments introduced by the Act 31/2014, of 3 December, amending the Spanish Corporation Act for the improvement of the Good Corporate Governance. Additionally, among the amendments of the Regulations of the Board of Directors, the new recommendations introduced in the Good Corporate Governance Code for Listed companies have been considered in the amendment of the Regulations of the Board of Directors.

#### *6. Other matters studied.*

##### *New Code of Good Governance for Listed Companies.*

The Committee studied the changes made by the New Code of Good Governance for Listed Companies, passed by decision of the Board of the CNMV (Spanish National Stock Markets Commission) on 18 February 2015, and their impact on Telefónica, S.A. Corporate Governance System.

Furthermore, the Committee reviewed all the matters regarding Corporate Governance rules, Codes and policies.

##### *Self-assessment of the Board, the Committees and the General Meeting.*

The Committee examined and analysed the results of the self-assessment carried out, by the Directors of the Company, of the operation of the Board of Directors, its Committees and the General Shareholders' Meeting regarding fiscal year 2015, and reported to the Board on its conclusions.

### *2014 Annual Corporate Governance Report.*

On a different matter, the Committee reviewed and issued a favourable opinion, at its meeting of the 22 February 2015, on the content of the Telefónica, S.A. Annual Corporate Governance Report for the 2014 financial year, which adjusted the model set down in Circular 5/2013, of 12 June, published by Spain's CNMV. This Report was passed by the Company's Board of Directors at its meeting on 23 February 2015.

### *Annual Report on Executive Remuneration 2014.*

Equally, the Committee studied and issued a favourable opinion on the Report on Directors Remuneration 2014 at its meeting on 22 February 2015, which sets out in full detail, the fundamental criteria and parameters used to set the remuneration structure for the Company's Board of Directors and Executive Directors.

This Report was passed by the Company's Board of Directors at its meeting on 23 February 2015, and by the General Shareholders' Meeting at its meeting on 12 June 2015 on a consultative vote.

### *Selection Policy of Telefónica, S.A. Board Members*

The Committee, at its meeting on 24 November 2015, studied and issued a favourable opinion of the Selection Policy of Telefónica, S.A. Board Members.

This Policy was passed by the Company's Board of Directors at its meeting on 25 November 2015.

The criteria followed on the Selection Policy, which were already established on the Regulations of the Board of Directors, were considered in the proposal for appointing of the Director submitted by the Committee.

### *Telefónica, S.A. Policy on Information, Communication and Contract with Shareholders, Institutional Investors and Vote Advisor.*

Likewise, the Committee studied and issued a favourable opinion, at its meeting on 24 November 2015, the Telefónica, S.A. Policy on Information, Communication and Contract with Shareholders, Institutional Investors and Vote Advisors.

This Policy was approved by the Company's Board of Directors at its meeting held on 25 November 2015.

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