



4



Responsible business

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

Sustainability governance and management

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

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

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

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

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

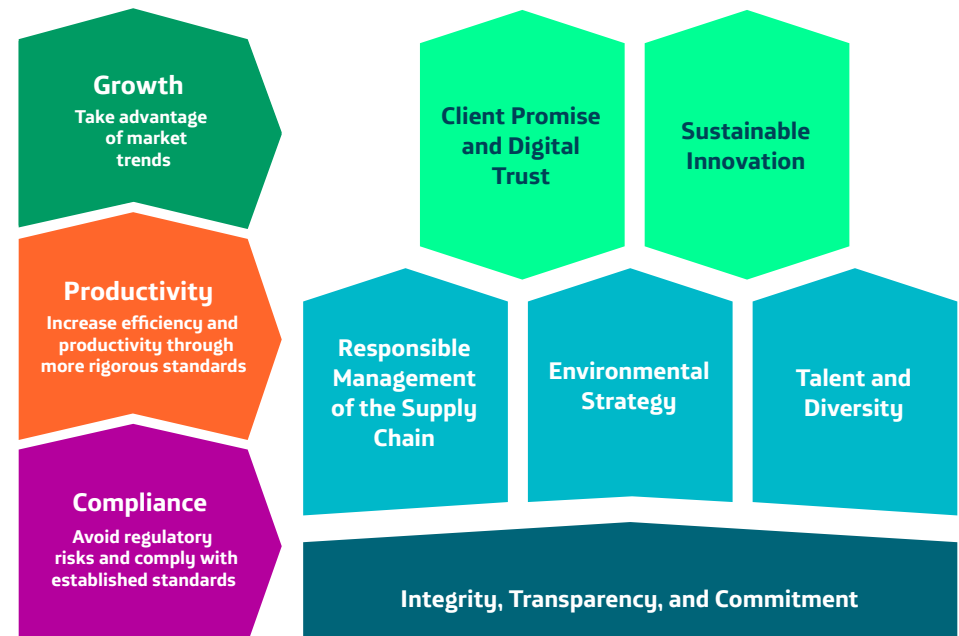


This work path takes concrete form in different local plans in the countries where we are present. Thus, in 2016, in addition to the Global Responsible Business Plan, the plans for Germany, Argentina, Brazil, Chile, Colombia, Ecuador, Spain, Mexico, and Peru were also approved.

In this way, our sustainability strategy is based on the responsible management of our business, not only focused on managing certain risks, but also on seizing opportunities, efficiency, and sustainable growth. This allows us to contribute to the social and economic development of society, allowing the communities in which we operate to be more

prosperous and to have better and more inclusive drivers of progress. Thus, we link the responsible business objectives with the development and management of the business, incorporating them into our processes and goals so that they become part of our essence as a Company.

GLOBAL RESPONSIBLE BUSINESS PLAN



ACTION MODEL

Growth:

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

Productivity:

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

Compliance:

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

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

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

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

SUSTAINABLE DEVELOPMENT GOALS



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

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

HOW WE GOVERN SUSTAINABILITY

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

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

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

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

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

- ▶ Internal audit units in all the countries in which we maintain significant interests.
- ▶ An inspection unit specialising in fraud prevention work and the investigation of complaints.
- ▶ A payments intervention unit in the most important companies.



- ▶ Global management and local sustainability units.
- ▶ A corporate risk management unit which centralises and reports the risk information received from the local risk management areas implemented in the main operators.
- ▶ Responsible Business Offices in each country.
- ▶ A global Compliance unit, created in 2016, that reports directly to the Board of Directors, and which has the goal of reinforcing and promoting ethical culture throughout the Company.

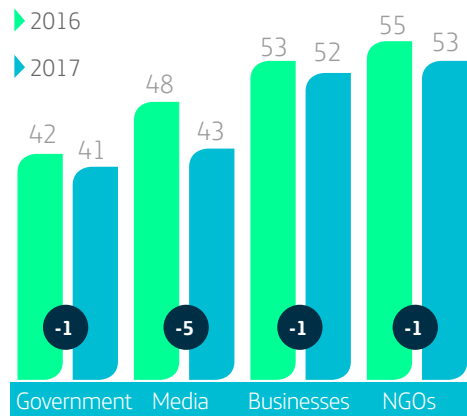
Managing our stakeholders and reputation_

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

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

THE TRUST IN INSTITUTIONS IS DETERIORATING

Percentage of trust
(According to the Edelman Trust Barometer)



We understand that this is a challenge, but it is also an opportunity to strengthen the connection with our stakeholders. Particularly

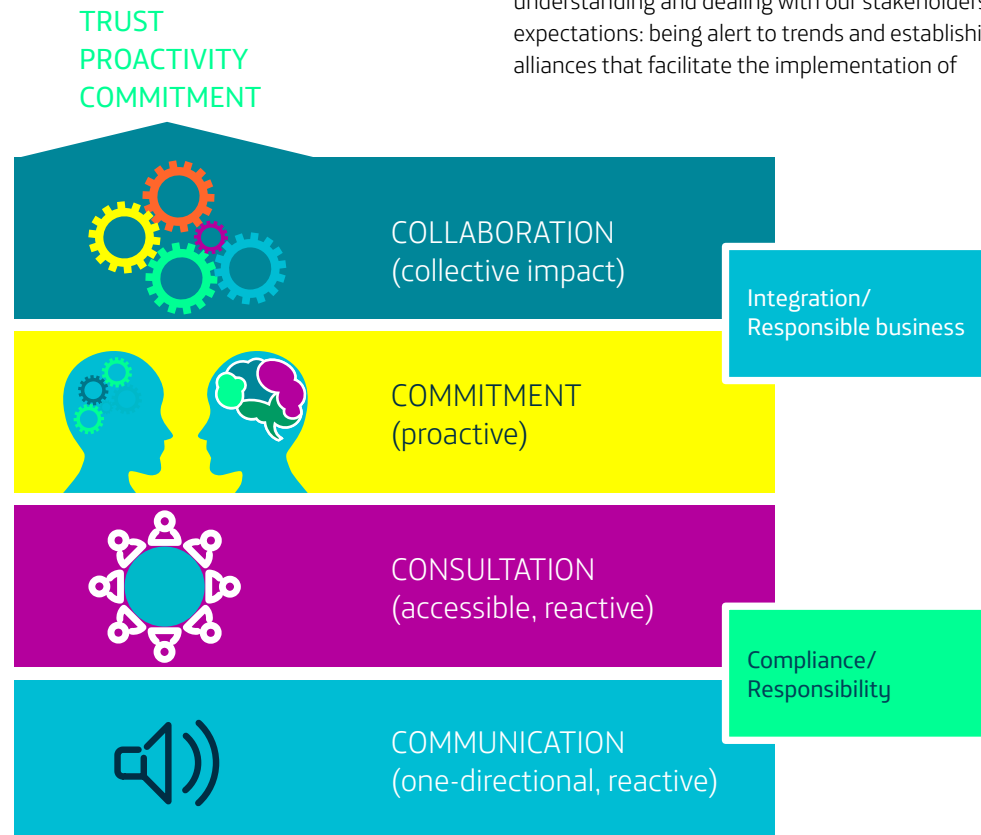
keeping in mind the current context, in which society demands that companies play a role that goes beyond mere economic development.

The keys to rebuilding trust are based on understanding and dealing with our stakeholders' expectations: being alert to trends and establishing alliances that facilitate the implementation of

measures that jointly generate benefit and improve the economic and social conditions of the communities in which we operate.

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

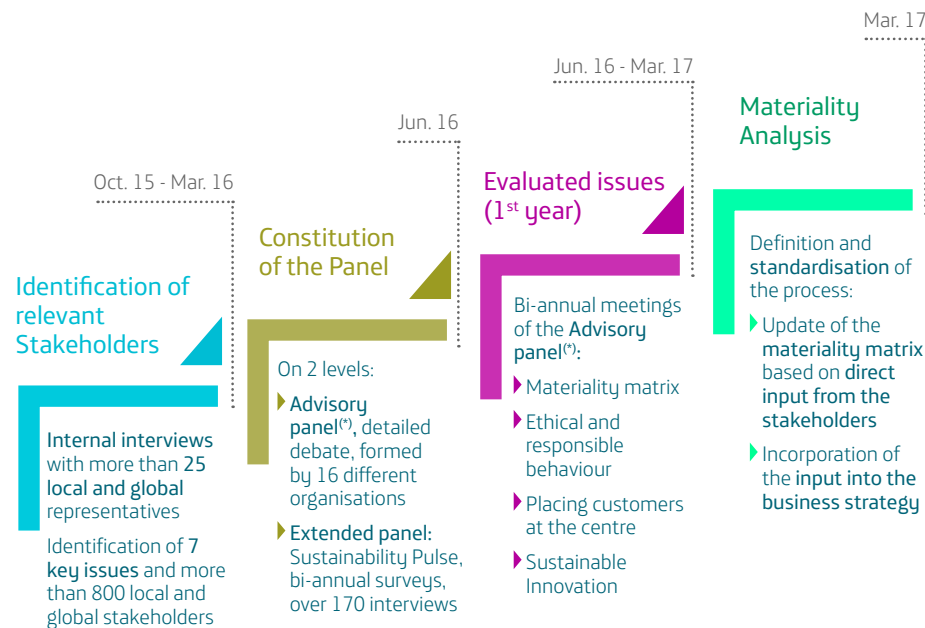
Society demands that we, *as a company*, play a role that goes beyond mere *economic development*



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

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

THE ROUTE TO A SOLID, HOMOGENEOUS AND INNOVATIVE PROCESS



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

IDENTIFICATION OF 7 SIGNIFICANT ISSUES



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

RESPONSIBLE BUSINESS ADVISORY PANEL

- ▶ Platform for structured dialogue.
- ▶ Formed by experts from 16 organisations with a global focus and from the major markets (Spain, Germany, Brazil, Mexico and Chile).
- ▶ Quarterly meetings.
- ▶ One critical issue debated per meeting, with detailed feedback.
- ▶ The area in charge of managing the issue on debate. It presents Telefónica's strategy and answers the panelists' questions.

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

Customers



Suppliers



Investors



NGOs



Industry organisations



Multi-industry organisations



Professional services



Best Practices



FIRST YEAR ASSESSMENT

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



Chairman of the Panel

**ERNST
LIGTERINGEN**
Cooperability

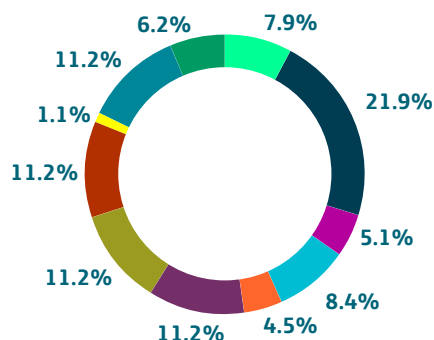
The following level allows us to identify the significant issues, while also covering our entire geographic footprint.

EXTENDED PANEL

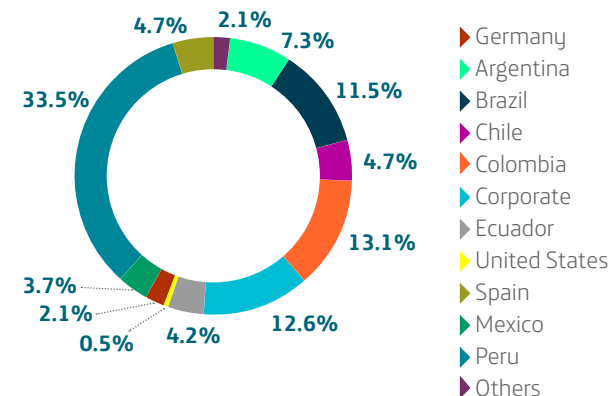
- ▶ Platform for measuring the perception and identification of trends.
- ▶ Variable pull from stakeholders. Local and global focus. In 2016 it was comprised of more than 170 organisations representing the countries where we have a presence.^(*)
- ▶ Bi-annual online consultations, which go deeper into the issues identified by the Advisory Panel.
- ▶ Getting the "Telefónica Stakeholder Pulse".
- ▶ Input for the Advisory Panel, for the areas of internal management and for development of the materiality matrix (local and global).

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

The composition of the Extended Panel in 2016 was:



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



MAIN FINDINGS FROM THE EXTENDED PANEL

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

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

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

- ▶ The key aspects that these stakeholders consider most relevant to the ICT sector, both now and in the near future, is customer centred management and ethical and responsible behaviour.
- ▶ Management of the supply chain is where the least evolution is perceived.
- ▶ In addition to the evaluated issues, two new categories suggested by experts have been identified: the need for internal and external alignment with the Company's purpose and management of the corporate reputation in general.

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

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



ALIGNMENT WITH TELEFÓNICA'S PURPOSE

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

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

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

OTHER DIALOGUE CHANNELS

CUSTOMERS



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

Examples of engagement and interaction with customers:

- For residential customers we have customer service channels in each of our geographical areas, with the [Movistar Community](#); in addition to our Twitter profiles ([Telefónica on Twitter](#), [Movistar on Twitter](#), among others).
- In the field of large corporate and multinational customers, in addition to our Business Solutions division, we should highlight the TBS (Telefónica Business Solutions) Quality Week, the Telefónica Leadership Conference and other events such as the International Telecoms Week.

SHAREHOLDERS



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

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

SUPPLIERS



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

Examples of engagement and interaction:

- ▶ The **Aliados Programme**, implemented in our main operations in Latin America.
- ▶ Meetings with some of our main suppliers at a global level to share our strategies on sustainability issues and to exchange best practices.
- ▶ Energy and Climate Change Workshops organised annually by Telefónica and attended by some of our main suppliers.

INDUSTRY ORGANISATIONS



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

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

INTERNATIONAL ORGANISATIONS



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

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

EMPLOYEES



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

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

Best practices:

- ▶ During 2016, we launched an Intranet with the description of the Company programme 'Elige Todo', which received a total of 738,368 visits.
- ▶ We sent out weekly global newsletters, which describe the Company's current status, as well as topics related to our strategic programme.
- ▶ Más allá del Power Point (Onlife TV) (Beyond Power Point): was a series of explanatory videos about our Company programme. Each season (we currently have 4) is focused on different strategic lines. During 2016 it received 280,000 views.

NON-GOVERNMENTAL ORGANISATIONS



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

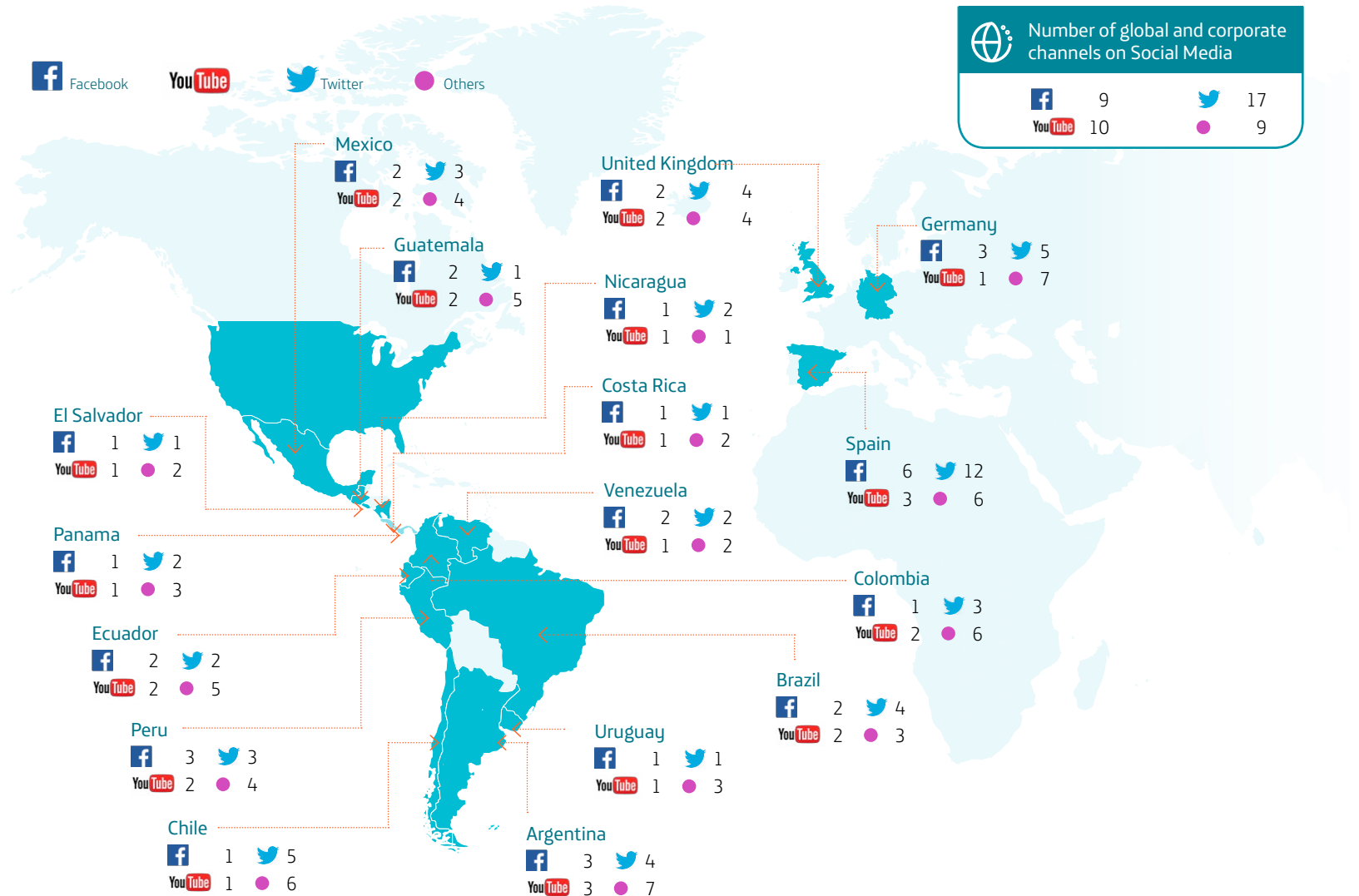
Best practices: In the case of Spain, we collaborate with more than 25 NGOs, by means of the Premium messaging service, delivering to the NGO 100% of what customers give in the solidarity SMS.

Examples of engagement and interaction:

Fundación ONCE - ILUNION, Red Cross, UNICEF, Oxfam Intermón, International Plan, ACNUR, Spanish Committee of Representatives of People with Disabilities (CERMI), National Centre of Accessibility Technologies (CENTAC).

TELEFÓNICA CHANNELS ON THE SOCIAL NETWORKS

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



MANAGING AND MEASURING REPUTATION

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

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

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

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

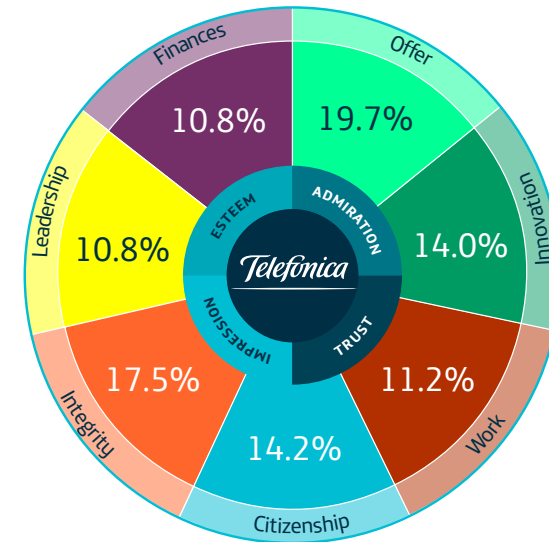
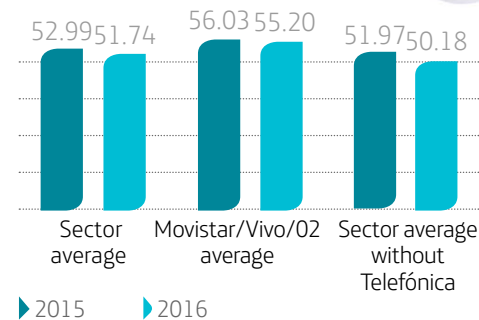
General Public Reputation

The reputation of the sector in the countries where we operate remains stable; with the observation of a statistically insignificant year-on-year fall of about 1 point.

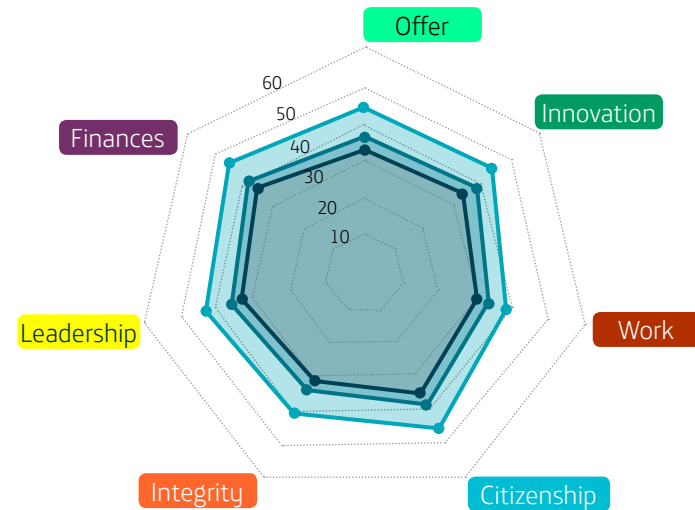
To search for levers to understand and trigger activate these movements, the RepTrak Pulse performs a more rational evaluation of the Company's performance by means of the RepTrak Index indicator. The rational indicator, in the case of General Public, is built upon seven dimensions: Offer, Work, Integrity, Leadership, Innovation, Citizenship and Finance.

The weight of each dimension is adjusted annually, and it is worth highlighting that the weight that the Integrity dimension achieved in 2016, according to the model of weights, accounts for 17.5% of the sector's reputation, and is only surpassed by the Offer dimension, which includes commercialisation, provision and after-sales. Evolution of the sector and of our commercials brands is:

GENERAL PUBLIC REPUTATION



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



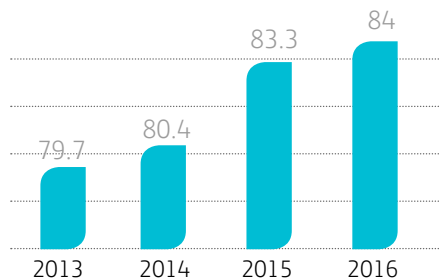
— Sector average — Movistar/Vivo/O2 average — Sector average without Telefónica

Reputation among our employees

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

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

REPUTATION OF TELEFÓNICA AMONG ITS EMPLOYEES



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

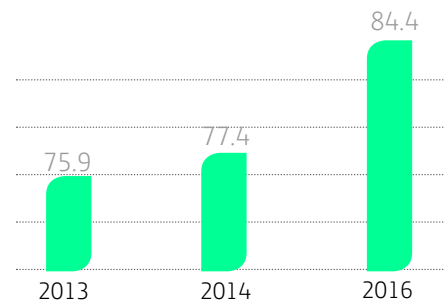
Reputation among our suppliers

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

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

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

REPUTATION OF TELEFÓNICA AMONG ITS SUPPLIERS



The aspects that most influence construction of our reputation among this group of stakeholders are Leadership and Sustainability.

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

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

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



SOME OF THE ASSOCIATIONS WITH WHICH TELEFÓNICA PARTICIPATES



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



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



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



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



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



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



The **CEOE** is the institution that represents Spanish entrepreneurs.



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



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



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



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



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



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



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



ETNO is an association which encompasses the major European operators.



ETSI, the European Telecommunications Standards Institute.



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



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



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



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



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



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



The **GSMA** represents the interests of mobile operators worldwide.



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



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



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



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



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



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



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



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



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



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



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



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



UN agency that works to defend children's rights.



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



Materiality analysis_

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

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

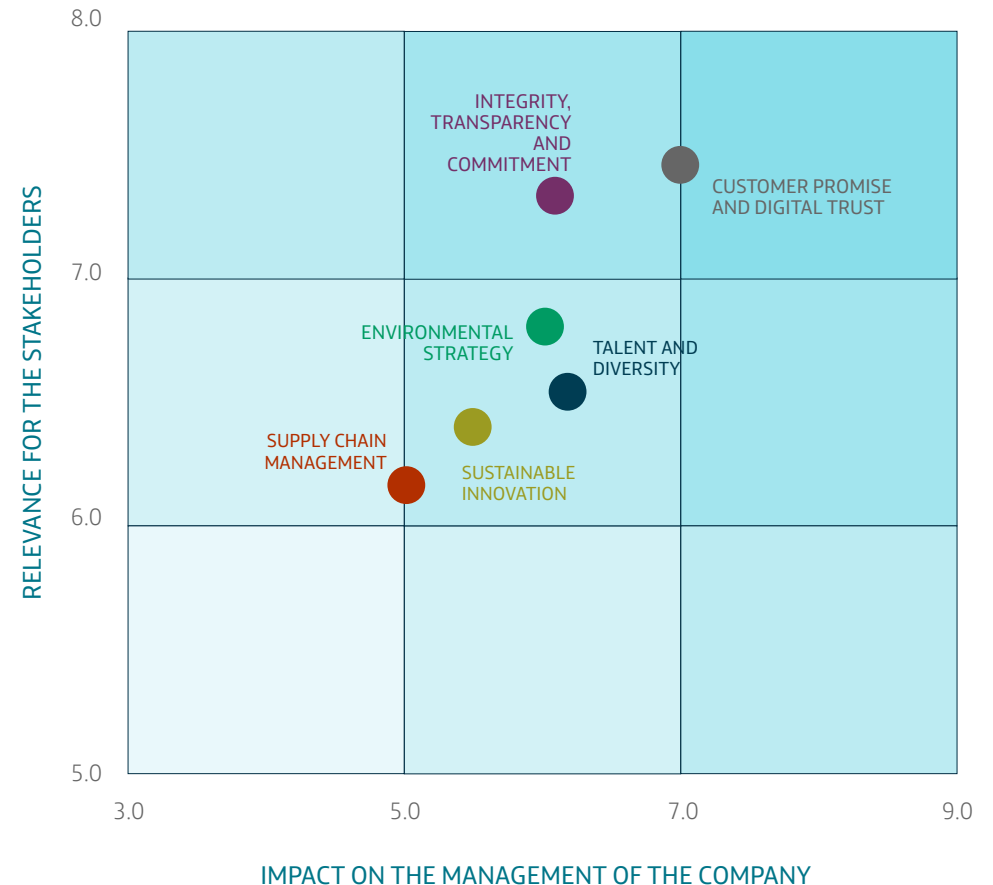
For the analysis we follow the indications of version G4 of the GRI Guide and, in order to increase the comparability and completeness of the matters under study, we begin with the materiality analysis conducted by the Global e-Sustainability Initiative (GeSI) for the whole **value chain of the ICT hypersector**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

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

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



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



Identifying and managing risks_

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

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

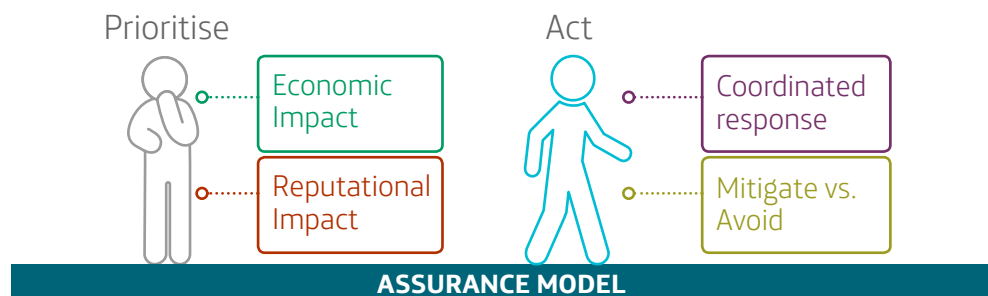
Through the Integrated Model for risk assurance and management, inspired by best practices, the prioritisation and development

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

RISK MANAGEMENT MODEL

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

PRIORITISATION AND ACTION IN THE FACE OF RISK



Four categories of risk are considered:

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

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

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

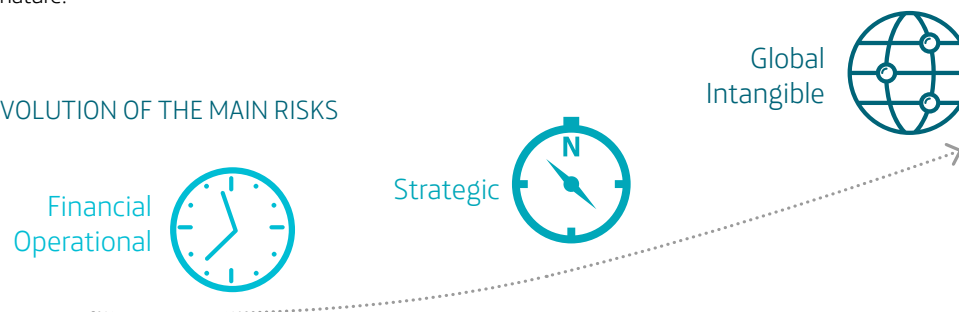
Also included in this category are risks of a fiscal nature.

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

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

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

EVOLUTION OF THE MAIN RISKS



RISK MANAGEMENT GOVERNANCE

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

Supervision of the risk management system

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

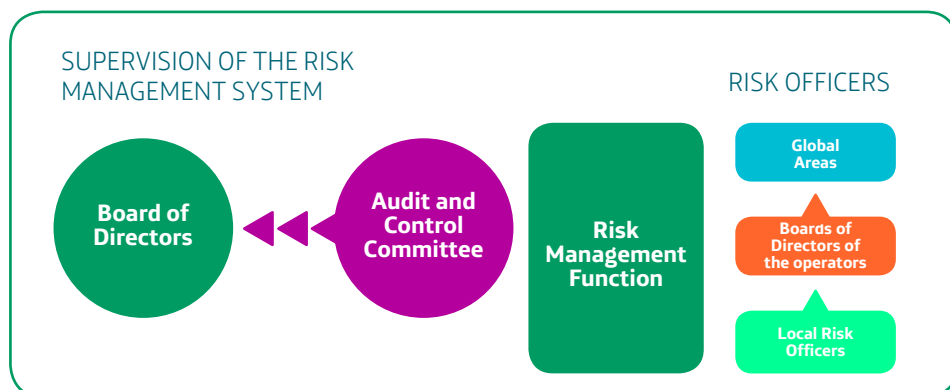
identified risks; and the control and information systems for controlling and managing the aforementioned risks.

Risk Officers

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

Risk management function

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



RISK MANAGEMENT PROCESS

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

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

Identifying risks

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

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

Assessing risks

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

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

RISK MANAGEMENT PROCESS



Responding to and monitoring the risk

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

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

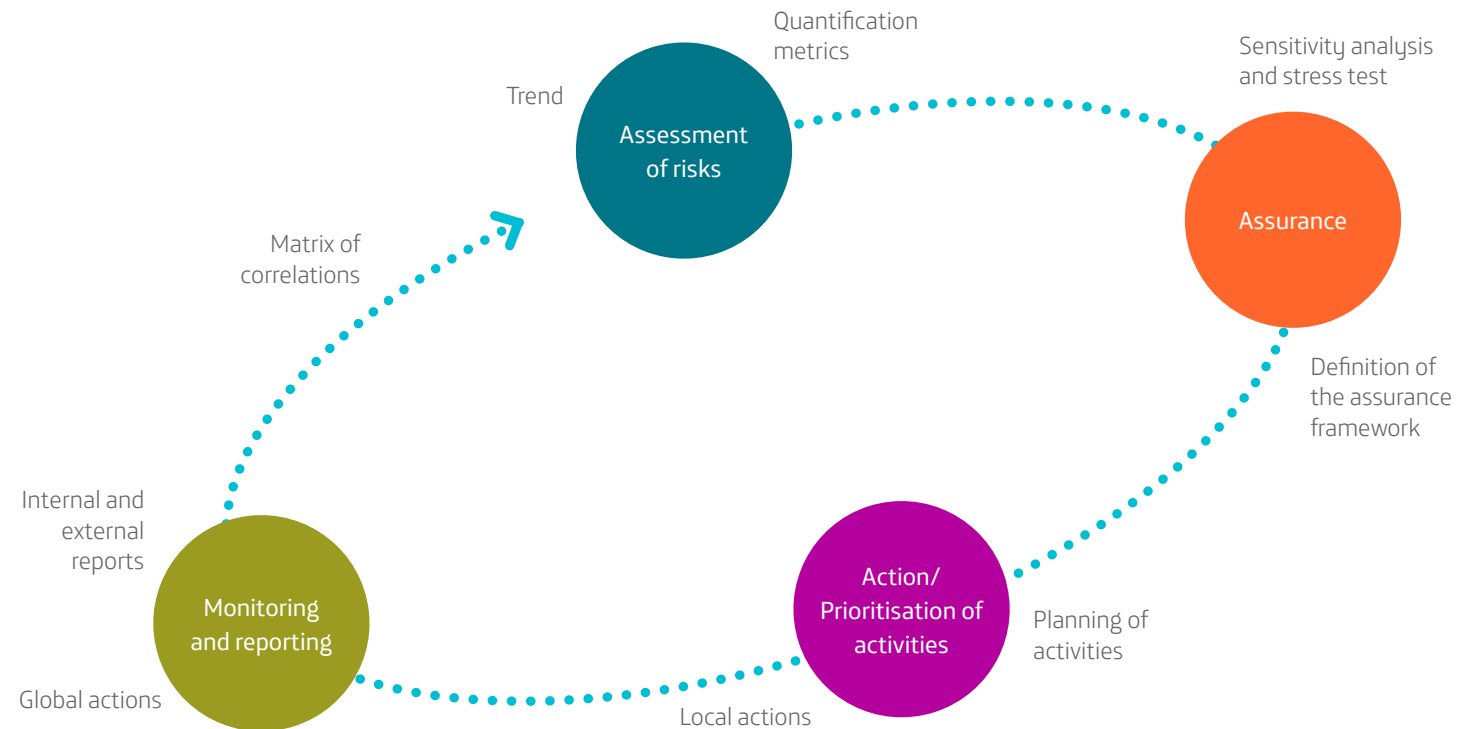
In matters such as risks of a fiscal nature, a monitoring of the main issues is performed. For specific, operational type risks, Multinational Insurance Programmes, or insurance policies negotiated locally in each country, are available depending on the type of risk and its coverage.

Risk tolerance and acceptable risk

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

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

GENERAL OUTLINE OF THE RISK MANAGEMENT MODEL



Risks and uncertainties faced by the Company

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

- ▶ Deterioration of the economic or political environment may negatively affect our business.
- ▶ The results and financial situation of the Group may be affected if we do not effectively manage our exposure to exchange rates of foreign currencies or their interest rates.
- ▶ Changes in accounting regulations may influence the reported benefits.
- ▶ We operate in a heavily regulated industry, which requires qualified professionals to authorise the provision of many of its services, as well as the use of the spectrum, which is a scarce and expensive resource.

- ▶ We are exposed to risks with regard to compliance with legislation against corruption and economic sanction programmes.
- ▶ The customer perception of the services we offer may be disadvantageous with regard to those offered by competing companies.
- ▶ We may not adequately anticipate and adapt to the technological changes and trends of the sector.
- ▶ We rely on a network of suppliers.
- ▶ Any possible Network failures may lead to a loss of quality or a service interruption.
- ▶ The telecommunications industry may be affected by the potential effects that the electromagnetic fields emitted by mobile devices and base stations may have on people's health.
- ▶ Potential changes of a regulatory, business, economic, or political nature may lead to the possible reorganisation of certain assets.
- ▶ The Telefónica Group's networks transport and store large volumes of confidential, personal and business data, and its Internet access and hosting services may give rise to claims due to the illegal or illicit use of the Internet.
- ▶ Telefónica and the Group's companies are parties in litigations, claims of a fiscal nature, and other legal proceedings.



Business ethics and compliance_

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

HOW DO WE RELATE WITH OUR STAKEHOLDERS?



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

MANAGEMENT FOCUS

WHY IS IT A KEY ISSUE?



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

WHERE IS THE IMPACT?



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

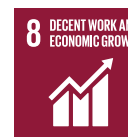
TELEFÓNICA'S OBJECTIVE



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

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

SUSTAINABLE DEVELOPMENT OBJECTIVES



OUR CHALLENGE

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

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

Our commitments with regard to ethics and compliance are manifested in:

► Responsible Business Principles

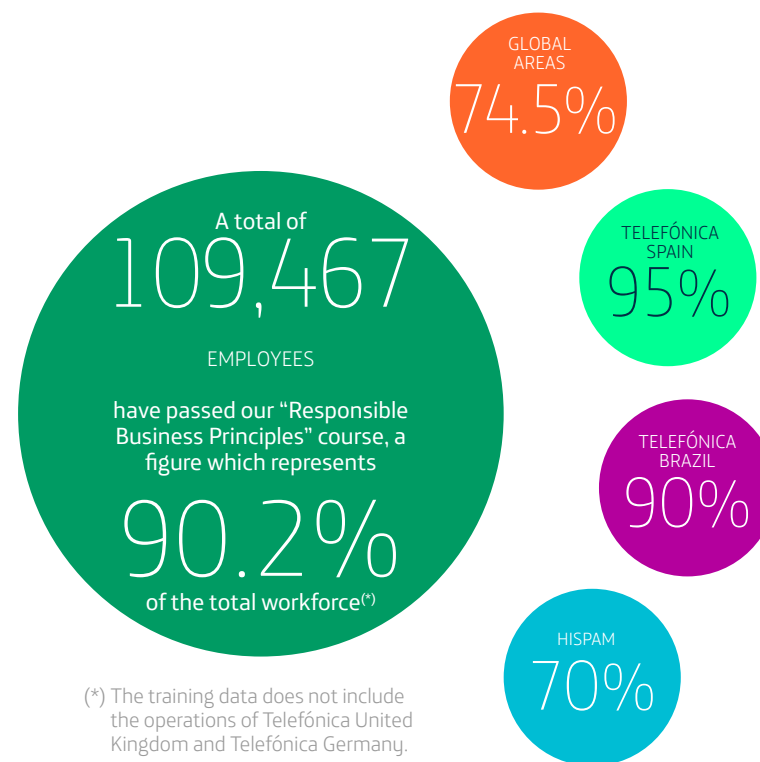
These reflect our ethical and responsible performance commitments to our different stakeholders, and contain the ethics code that must govern the actions of each of our employees. These Principles simultaneously develop relevant Policies and Regulations, such as the Anti-Corruption Policy or the Corporate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

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

RESPONSIBLE BUSINESS PRINCIPLES

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

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



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

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

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

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

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

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

RESPONSIBLE BUSINESS CULTURE

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

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

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

POLITICAL NEUTRALITY

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

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

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

COMPLAINTS AND COMMUNICATIONS CHANNELS

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

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

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

with the principles of respect, confidentiality, and comprehensiveness.

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

BEST PRACTICES

PLAY TO MOVE



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

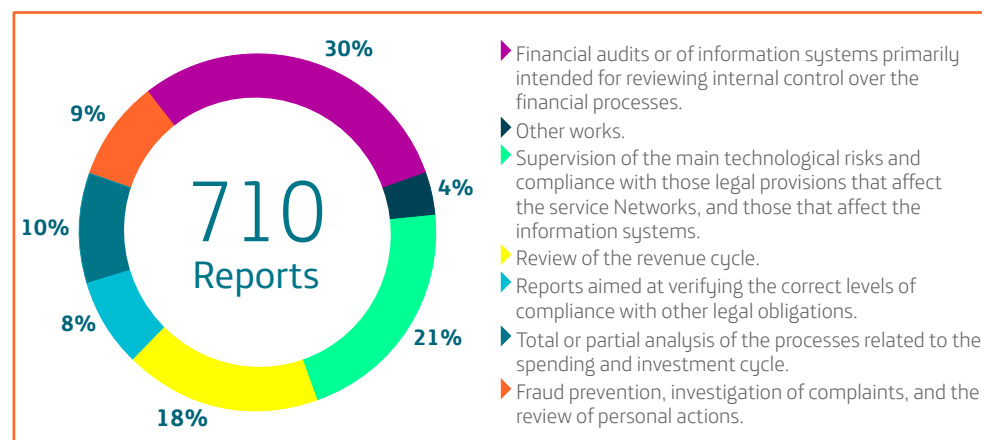
In 2016, we registered a total of:



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

INTERNAL AUDIT

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



MILESTONES IN 2016

- Creation of a communications channel for external stakeholders. 100% Achieved
- Revision of the internal regulations. Revision of the Responsible Business Principles. In progress
- Communications campaign on the Responsible Business Principles. 100% Achieved
- Delivery of a training course on the Responsible Business Principles (participation of 90% of the workforce). 100% Achieved

CHALLENGES FOR 2017

- Incorporation in the analysis of stakeholder expectations regarding requests and complaints made.
- Final approval and communications campaign to employees about the Responsible Business Principles.
- Internal communications campaign linked to the new Responsible Business Principles.
- Training course on the Responsible Business Principles (maintain participation of 90% of the workforce).

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

Managing the supply chain_

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

HOW DO WE INTERACT WITH OUR PROVIDERS?



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

MANAGEMENT FOCUS:

WHY IS IT A KEY ISSUE?



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

WHERE IS THE IMPACT?



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

TELEFÓNICA'S 2017 OBJECTIVE



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

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

SUSTAINABLE DEVELOPMENT GOALS



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

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

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

THE SUPPLY CHAIN IN NUMBERS

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

30,058 M€⁽¹⁾
negotiated electronically

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

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

- ▶ We continue to make progress in the interconnection between the systems of Telefónica's companies and those of our suppliers, achieving a 171% increase in the number of orders placed between 2015 and 2016.
- ▶ More than 8,900 suppliers were trained in the management of negotiations, orders and electronic invoices.

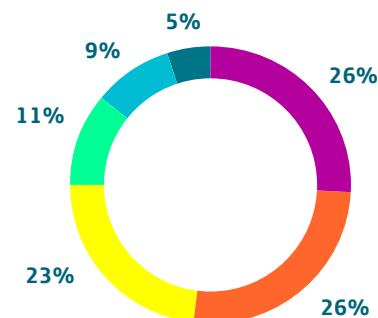
IMPACT ON THE COMMUNITY

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

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

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

AWARDED PURCHASE VOLUME



- ▶ Network
- ▶ Mobility
- ▶ Services and Works
- ▶ Information Systems
- ▶ B2B/B2C Solutions
- ▶ Advertising and Marketing

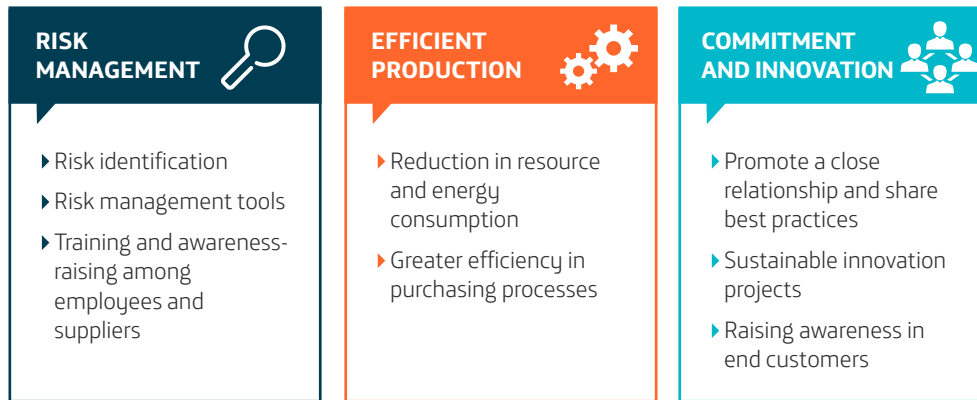
26,063 M€⁽²⁾
awarded...

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

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

SUSTAINABLE MANAGEMENT MODEL

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



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

RISK MANAGEMENT

IDENTIFYING RISKS

In order to properly manage our supply chain, we focus on the suppliers that are most significant to our Company, either because of their level of risk or because of their impact on

our business given the volume awarded. We do this on the basis of a previous analysis which has been reviewed and updated over the past year.

HOW DO WE DO IT?

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

GENERAL ASPECTS

- ▶ Nature of the activity
- ▶ Geographic location
- ▶ Brand association
- ▶ Visibility for customers
- ▶ Visibility for other external stakeholders



SUSTAINABILITY ASPECTS

- ▶ Privacy/Data Protection
- ▶ Working conditions
- ▶ Health and Safety
- ▶ Environmental
- ▶ Human Rights (Child labour)
- ▶ Minerals from areas of conflict

REGULATORY FRAMEWORK FOR SUPPLIERS

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

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

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

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

- ▶ The Supply Chain Sustainability Policy.
- ▶ The Anti-Corruption Policy.
- ▶ The General Conditions for the Supply of Goods and Services of the Telefónica Group.

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

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

SUPPLY CHAIN SUSTAINABILITY POLICY

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

MINIMUM STANDARDS FOR RESPONSIBLE BUSINESS

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

ETHICAL

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

PRIVACY AND CONFIDENTIALITY OF INFORMATION

- ▶ Information
- ▶ Personal data

SOCIAL

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

ENVIRONMENTAL

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

TOOLS FOR COLLABORATION, EVALUATION, VERIFICATION AND IMPROVEMENT

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

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

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

Aliados Programme

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

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

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

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

- ▶ Implementation of a contractor monitoring system (in Argentina, Brazil, Chile, Mexico and Peru).
- ▶ We continued the implementation of OSHAS 18001, which also involves suppliers in different countries (Argentina and Colombia).
- ▶ In Argentina, through the Portal Aliados application, we incorporated the necessary standards in all the intermediary processes (pay rolls, user management, etc.), simplifying the different processes and minimising our exposure to risk. In addition, we began a digitisation process (using certified signatures) for documents provided by suppliers.
- ▶ In Brazil, we completed the process of incorporating GVT suppliers into the Aliados programme, which had begun following acquisition.
- ▶ In Colombia we developed and initiated the Model for integration with Management Systems (Environmental, Quality, Safety and Security at work, and Information Security) for our partners. In addition, we continued implementing the Aliados' management model in the distribution channel, through which we guaranteed the inclusion of the conditions on Human Resources and Occupational Health and Safety in the contracts.

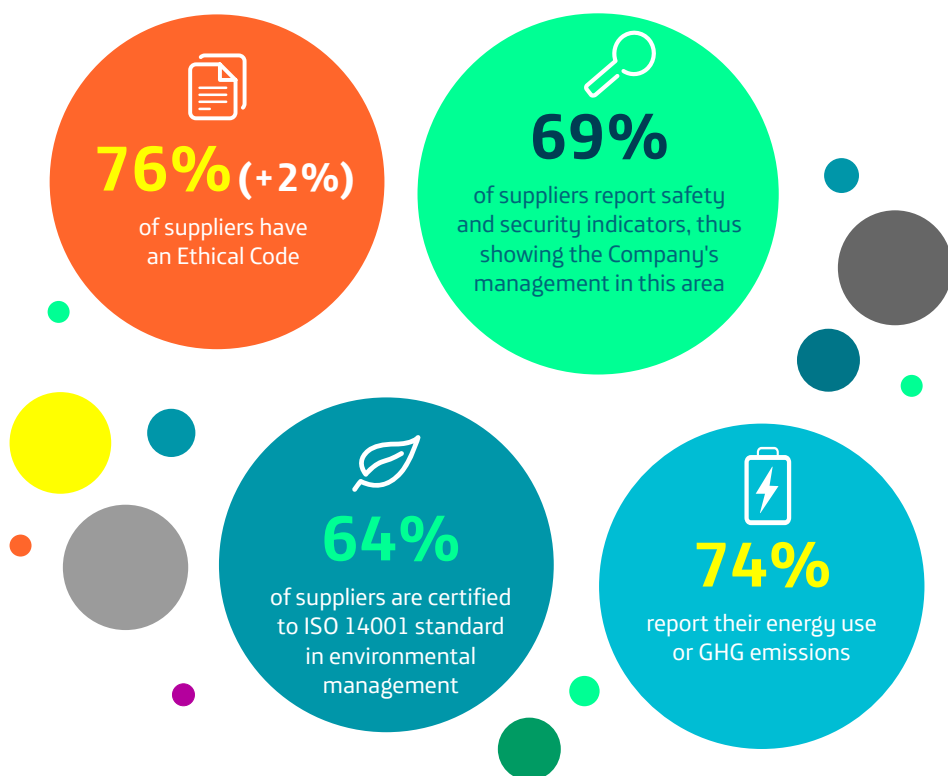
EcoVadis

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

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

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

RELEVANT INDICATORS REGARDING OUR EVALUATIONS



Joint Audit Cooperation (JAC)

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

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

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

Laborlink Mobile Surveys

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

Last year, we coordinated the launch of 3 mobile telephone surveys, involving our suppliers in the continuous improvement of our Supply Chain.

We verify compliance in the factories of the providers of our suppliers, working also to ensure *the second level of our supply chain*

THE ANNUAL AUDIT PLAN IN NUMBERS

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

LATIN AMERICA

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

Audits on critical issues at a local level

Corporate audits on homogeneous sustainability criteria.

1,002
on-site audits

328
suppliers with improvement plans as a result of the audits

10,369
administrative audits

106

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

102

suppliers with improvement plans as a result of the audits

EUROPE

Network, works and services, and SIM card suppliers

12

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

11

suppliers with improvement plans as a result of the audits

SECTOR INITIATIVE JAC

Manufacturing centres of multinational suppliers in the ICT sector

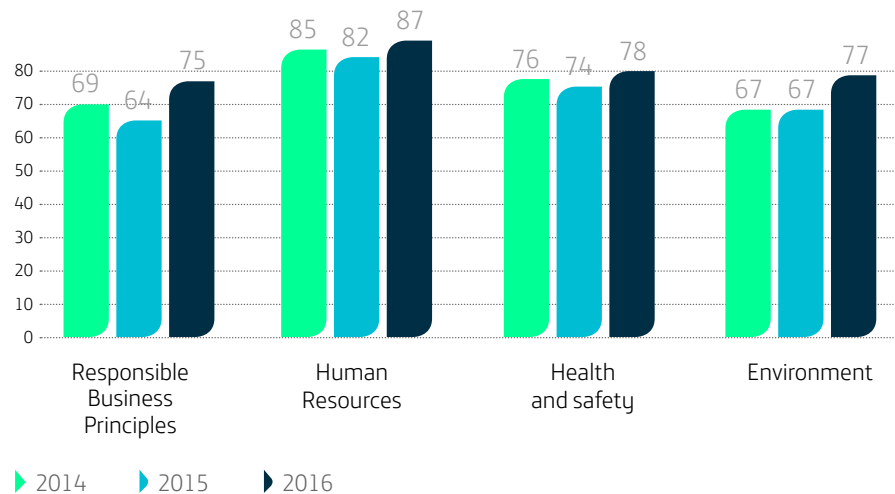
51

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

27

suppliers with improvement plans as a result of the audits

% OF COMPLIANCE WITH CORPORATE AUDITS IN LATIN AMERICA



Details of corporate audits

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

Some of the most common risks have been detected in:

- The Induction Process, Training and Work Environment, as well as Personnel Relationships and Personnel Management.
- In terms of Health and Safety, we have concentrated on the sections of Hygiene and Industrial Safety, Implementation and Operation, and Verification.
- And in environmental processes, in the management of waste and the environmental management system.

KEY ASPECTS IN OUR SECTOR

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

Privacy and Data Protection

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

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

In addition, in line with the minimum privacy standards stipulated in our Policy and in the General Conditions for the Supply of Goods

and Services, we promote a series of security measures among our suppliers that guarantee compliance with our internal regulations in the areas of security and good use of personal data.

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

Minerals in conflict

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

1. Traceability of 3TG minerals.

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

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

2. Supplier evaluation and audit. We analyse and evaluate our suppliers' commitment through the EcoVadis platform and audits performed by the [Joint Audit Cooperation](#) sector initiative.

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

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

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

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

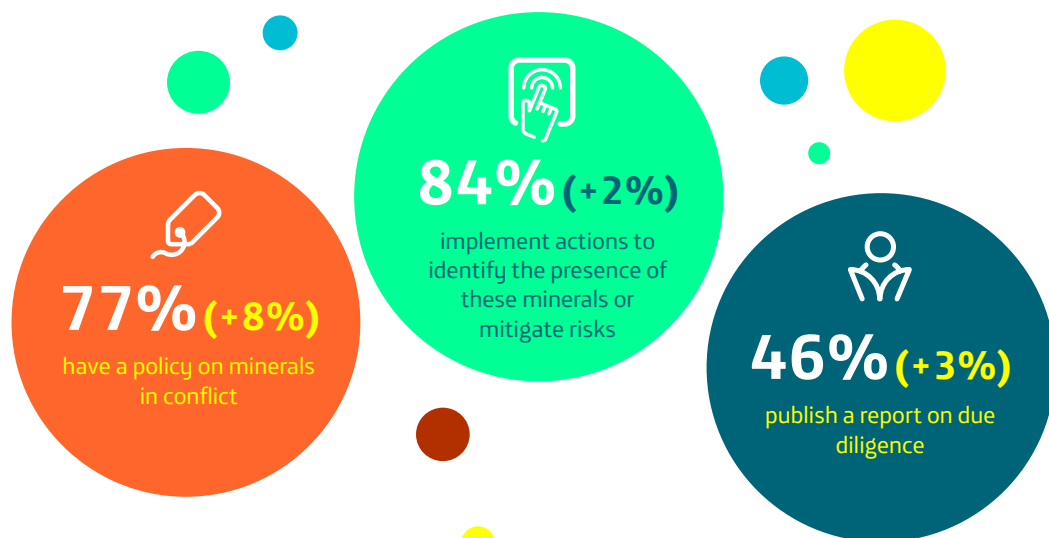
In addition, as a company listed on the New York Stock Exchange, we duly comply with Section 1.502 of the Dodd-Frank Wall Street Reform and the Consumer Protection Act.

TRAINING AND RAISING AWARENESS

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

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

AMONG THE SUPPLIERS ASSESSED:



EFFICIENT PRODUCTION



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

MARCO POLO MODEL

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

TECHNOLOGICAL PARTNERS

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

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

- ▶ Efficiency in electronic equipment (rectifiers, UPS and inverters).
- ▶ Improved efficiency in refrigeration and air conditioning units.
- ▶ Reduction in energy consumption at radio bases at periods of low load.
- ▶ Lighting, selective shut-downs, hybrid and renewable generation.

COMMITMENT AND INNOVATION



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

SATISFACTION SURVEY

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

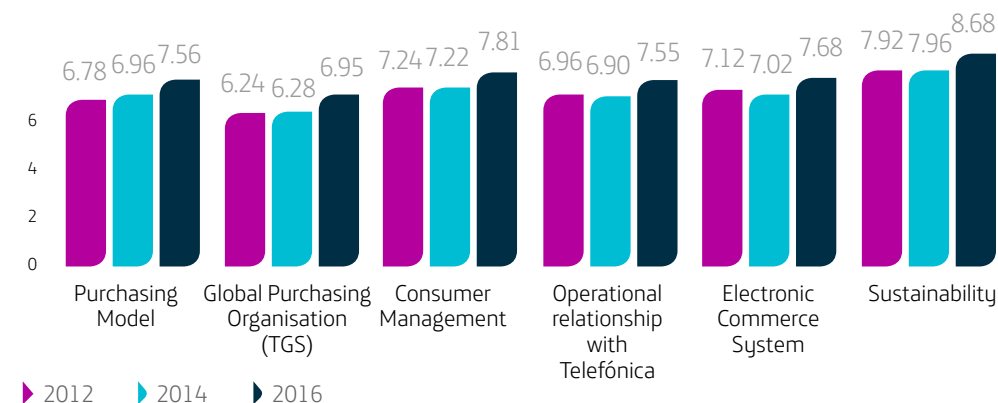
- ▶ We launched a survey of some 3,800 suppliers, reaching a participation level of 24%.

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

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

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

RESULTS OF THE SUPPLIER SATISFACTION SURVEY



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

DIALOGUE WITH OUR SUPPLIERS

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

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

- In 2016, we held direct meetings with some of our main global suppliers, at which we shared our strategies on sustainability issues and exchanged good practices.
- On a local level, we also organise on-site events with suppliers, including the following:
 - The 3rd Meeting of Telefónica Partner Companies in Chile, where we presented the

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

- A workshop organised in Brazil where we discussed the principle risks for suppliers in the country, local legislation on anti-corruption, our Sustainability strategy and our new Telefónica Chain Sustainability Policy with the 25 suppliers present.
- Themed workshops, such as one on Energy and Climate Change (held in Uruguay) where, together with our principal suppliers, we analysed plans to promote energy efficiency and to reduce CO₂ emissions in the world of telecommunications.

► Evaluating emissions in the supply chain.

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

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

RAISING AWARENESS AMONG OUR CUSTOMERS

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

BEST PRACTICES

III SUPPLIER SUSTAINABILITY FORUM IN THE UNITED KINGDOM

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

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

programme for carbon reduction or a plan to create one.

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

REDUCING CARBON IN THE SUPPLY CHAIN

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



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

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

For further information, see the chapters on ‘Environment’.

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

For further information, see the chapter on ‘Accessibility’.

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

MILESTONES IN 2016



**100%
Achieved**

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



**100%
Achieved**

Place special emphasis on suppliers involved in provision of services



**100%
Achieved**

Telefónica joining the JAC (Joint Audit Cooperation)



**95%
Achieved**

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

CHALLENGES FOR 2017

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

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

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

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

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