

***NOMINATING, COMPENSATION AND CORPORATE
GOVERNANCE COMMITTEE OF THE BOARD OF
DIRECTORS OF TELEFÓNICA, S.A.:
OPERATION AND ACTIVITIES REPORT 2016***

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

I. INTRODUCTION

This document aims to make known the operation of the Nominating, Compensation and Corporate Governance Committee of the Board of Directors of Telefónica, S.A. (hereinafter the Company) and highlighting certain aspects regarding its roles, competences, and composition.

The Nominating, Compensation and Corporate Governance Committee was created in 1997 by the Board of Directors of Telefónica, S.A., under the name of Selection and Remuneration Committee, in order to examine and discuss issues related to the proposed appointments and dismissals of Directors and Senior Managers of the Telefónica Group, and its remuneration system.

Also, as a result of the amendment made in the Regulations of the Board of Directors of the Company to adapt it the Olivencia Report, on 22 July 1998 the Committee changed its name to Appointments and Remunerations Committee, and its roles and competences.

Similarly, and in accordance with the resolution adopted by the Board of Directors at its meeting on 26 June 2002, the Committee was renamed the Nominating, Compensation and Corporate Governance Committee, assigning it new roles in practices and recommendations for good corporate governance. In addition, the amendment of the Regulations of the Board of Directors agreed by this at its meeting on 28 November 2007, introduced technical improvements to its name, becoming Nominating, Compensation and Corporate Governance Committee.

Therefore, following the agreement of the General Shareholders' Meeting of the Company held on 31 May 2013, the rules applicable to this Committee were included in Article 40 of the Articles of Association (which had been previously laid down 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 quindicies of Corporation Act, and the recommendation 48 and 50 of the Good Corporate Governance Code for Listed Companies.

II. ROLES AND COMPETENCES OF THE COMMITTEE

The roles and competences of the Nominating, Compensation and Corporate Governance Committee are laid down in the aforementioned Article 40 of the Articles of Association and Article 23 of the Regulations of the Board of Directors.

Therefore, in accordance with the provisions of the said Article 23, the Nominating, Compensation and Corporate Governance Committee of Telefónica, S.A. is assigned, without prejudice to any other tasks that may be entrusted to the Board of Directors the following competences:

- 1) Assess the competences, knowledge and experience required on the Board of Directors. For this purpose, the roles and skills required by the candidates to fill each vacancy shall be defined and the time and dedication necessary for them to effectively perform their duties shall be assessed.
- 2) Set a representation target for the less represented gender in the Board of Directors and prepare guidelines on how to achieve that target.
- 3) Take to the Board of Directors the proposals for appointment of independent Directors for their appointment by co-optation or for their submission to the decision of the General Shareholders' Meeting, as well as proposals for re-election or removal of such Directors by the General Shareholders' Meeting.
- 4) Report on the proposals for the nomination of other Directors of the Company for their appointment by co-optation or for their submission to the decision of the General Shareholders' Meeting, and proposals for re-election or removal by the General Shareholders' Meeting. Also, inform on proposals for the appointment and removal of the Secretary and, where appropriate, the Deputy Secretary of the Board of Directors of the Company and proposals for the appointment, re-election and removal of Directors of its affiliate companies.
- 5) Report on proposals for appointment and removal of Senior Managers of the Company and its affiliate companies.
- 6) Report on proposals for appointment of members of the Executive Committee and other Committees of the Board of Directors as well as the respective Secretary and, where appropriate, the respective Deputy Secretary.
- 7) Propose to the Board of Directors the Appointment of the Independent Director as Coordinator among the independent Directors.

- 8) Organise and coordinate, together with the Chairman of the Board of Directors, the periodic assessment of the Board of Directors, in accordance with the laid down in the Regulations of the Board of Directors.
- 9) Report on the periodic assessment of the performance of Chairman of the Board of Directors.
- 10) Examine and organise the succession of the Chairman of the Board of Directors and, where appropriate, make proposals to the Board of Directors for such succession to occur in an orderly and planned manner.
- 11) Propose to the Board of Directors, within the framework established in the Articles of Association, the remuneration of Directors and review it periodically to ensure its suitability for the tasks performed by them in accordance with the provisions of Article 34 of the Regulation.
- 12) Propose to the Board of Directors, within the framework established in the Articles of Association, the extent and amount of remuneration, rights and economic rewards, the Chairman of the Board of Directors, of the executive Directors and Senior Managers of the Company, as well as the basic terms of their contracts, for purposes of contractual implementation.
- 13) Draw up and propose to the Board of Directors an annual report on the remuneration policy of the Directors.
- 14) Verify information on remuneration of Directors and Senior Managers contained in the various corporate documents, including the annual report on remuneration of the Directors.
- 15) Supervise compliance with internal codes of conduct of the Company and the corporate governance rules assumed by it, and in force at any given time.
- 16) Exercise all other powers assigned to the Nominating, Compensation and Corporate Governance Committee in the Regulations of the Board of Directors.

III. COMPOSITION OF THE COMMITTEE

Moreover, and with regard to its composition, in accordance with the provisions of Article 23 of the Regulations of the Board, the Nominating, Compensation and Corporate Governance Committee shall consist of the number of Directors that the Board of Directors determines at all times and cannot in any case be less than three, appointed by the Board of Directors. All members of that Committee must be external Directors, and most of them, should be independent Directors.

It also stated in that article that the Chairman of this Committee will, in any case, be an independent Director.

As of December 31, 2016, the composition of the Nominating, Compensation and Corporate Governance Committee is as follows:

- Mr. Francisco Javier de Paz Mancho(*) (Chairman)
- Mr. Peter Erskine
- Ms. Sabina Fluxá Thienemann (**)
- Mr. Gonzalo Hinojosa Fernández de Angulo
- Mr. Pablo Isla Álvarez de Tejera

(*) Mr. Francisco Javier de Paz Mancho was appointed Member and Chairman of the Nominating, Compensation and Corporate Governance Committee on 8 April 2016, replacing Mr. Alfonso Ferrari Herrero.

(**) Ms. Sabina Fluxá Thienemann was appointed Member of the Nominating, Compensation and Corporate Governance Committee on 27 April 2016, replacing Mr. Carlos Colomer Casellas.

The professional profiles of the Members of the Nominating, Compensation and Corporate Governance Committee are available to the public on the corporate website of Telefónica, S.A.:

https://www.telefonica.com/en/web/shareholdersinvestors/corporate_governance/comnombram

It should also be mentioned that on 8 April 2016, the Chairman of the Committee, Mr. Francisco Javier de Paz Mancho, was appointed "*Lead Independent Director*", by agreement of the Board of Directors of the Company.

As regards the Secretariat of this Committee, this corresponds to the Secretary General and of the Board of Directors of Telefónica, S.A., Mr. Ramiro Sánchez de Lerín García-Ovies, who advises equally on all legal matters relating to this Committee, with the support of Deputy General Secretary and of the Board of Directors of Telefónica, S.A., Ms. María Luz Medrano Aranguren, and the Director for the Securities Market and Corporate Governance, Ms. Consuelo Barbé Capdevila.

IV. OPERATING OF THE COMMITTEE

The Nominating, Compensation and Corporate Governance Committee meets as often as deemed appropriate to discuss matters within its competence (in most cases,

prior to the meeting of the Board of Directors of Telefónica), convened by the Chairman of the Committee.

In this regard, during 2016 the Nominating, Compensation and Corporate Governance Committee held 11 meetings.

These meetings lasted for about two hours each on average, with its members having devoted an adequate number of hours to the study and analysis of the matters dealt with.

With regard to the attendance, there is an individual attendance control for each of the members of the Committee, which takes place at the beginning of each meeting, and is entered in the corresponding Minutes. During 2016, all of the Members of the Committee have attended, present or represented by proxy, to all the meetings of the Committee.

The various matters submitted for deliberation and where appropriate, decision, are treated with proper depth at all meetings of the Committee. Its members are actively involved in different debates and discussions, stating their opinion for this when they deem it appropriate.

The deliberations of the Committee and the resolutions and decisions adopted by it, are documented in the corresponding Minutes of each meeting, which are drafted by the Secretary of said Committee after it has ended, and distributed to its members for approval and remarks. Subsequently, these are submitted as the first item on the agenda of the next session of the Committee, and are signed by the Secretary with the approval of the Chairman.

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

The Nominating, Compensation and Corporate Governance Committee is validly constituted with the attendance or by proxy of at least half of its members; and adopts resolutions through a majority of those attending. In case of a tie, the Chairman shall have the casting vote.

V. ATTENDANCE TO THE MEETINGS

As regards to those attending the meetings of this Committee they usually attend, in addition to its members, members of the management team of Telefónica, S.A. which due to the roles and competences assigned to them, can provide support and assistance to members of the Committee on issues that are examined at each of its meetings. Mainly the Director of Corporate Human Resources of Telefónica, S.A. and Director of Compensation of Telefónica, S.A. attend the meetings of the Committee.

VI. ISSUES DISCUSSED BY THE NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE DURING 2016

Of the issues that the Committee examines at its meetings held on 2016, some correspond to its roles and others respond to the interest generated in accordance with the competences that the Committee has assigned.

In the review and discussion of the issues raised by the Committee, the speakers usually accompany their statements with presentations and/or reports, having examined, discussed and studied mainly in 2016 the following issues:

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

According to the competences that have been assigned to it, the Committee has informed, throughout the meetings held, on those proposals concerning the Directors of Telefónica, S.A., examining the appointments that were proposed in response to solvency, competence, experience, professional and willingness of candidates to devote the time and effort required for the effective performance of their roles, considering only their personal characteristics and professional qualifications.

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

The Committee has also reported favourably and/or proposed the re-election and ratification of Directors of Telefónica, S.A. by the Annual General Shareholders' Meeting of the Company, taking into consideration and having assessed the roles performed and dedication provided by said Directors during the exercise of their

duties, and basing all the proposals in a previous analysis of the needs of the Board of Directors, which aim to promote the diversity of knowledge, experience and gender.

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

Also at its meeting held on 7 April 2016, the Committee reported favourably and presented to the Board of Directors the proposed nomination, as Executive Chairman, of Mr. José María Álvarez-Pallete López, replacing the hitherto Executive Chairman Mr. César Alierta Izuel.

Similarly, the Committee, at the meeting of 7 April 2016, proposed the appointment as Independent "Lead Director" of Mr. Francisco Javier de Paz Mancho, replacing Mr. Alfonso Ferrari Herrero.

Moreover, the Committee discussed the proposal on the new configuration of Consultative or Control Committees that support the Board of Directors of the Company, in terms of their organisation, structure and composition, in order to achieve the highest possible efficiency, and optimise the management of the current structure of corporate governance of Telefónica, S.A.

In addition, the Committee has informed throughout the sessions held, of the various proposals for appointment of Directors in the most important Affiliate Companies of the Telefónica Group.

2. Proposed appointments related to senior managers and organizational changes.

Similarly, the Committee analysed and reported about those proposals related to Senior Management of the Company and its Affiliate Companies, appraising the proposed appointments and the fitness and professionalism of the candidates, together with their curricula and their career within and beyond the Company.

3. Remunerative regime for the Boards, senior managers and employees of Telefónica Group.

With respect to compensation for Directors and Senior Managers, the Committee on Nomination, Compensation and Corporate Governance studied the current remuneration of the Board of Directors and the Company's Senior Management.

The Committee has also discussed other issues related to Senior Managers of the Company, among others, General Plans for exit from the Group.

4. Telefónica, S.A. Share Plans.

In connection with implementation of the Third Cycle of the Plan (2013-2016) of the First “*Performance & Investment Plan*” (PIP), approved by the General Shareholders' Meeting on 18 May 2011, and ended on 30 June 2016, the Nominating, Compensation and Corporate Governance Committee examined and reported favourably on the proposal regarding the no source of delivery of the shares corresponding to said third cycle., considering that the conditions of the aforementioned plan have not been met.

Furthermore, with regards to the Third Cycle (2016-2019) the Second “*Performance & Investment Plan*” (PIP), approved by the General Shareholder's Meeting on 30 May 2014, the Nominating, Compensation and Corporate Governance Committee examined and reported favourably on the proposal regarding the no implementation of such considering that it was not aligned enough with the strategic plan of Telefónica Group, taking into account the circumstances and the macroeconomic environment.

5. Other matters studied.

Self-assessment of the Board, its Committees and the General Meeting 2016.

The Committee reviewed and discussed at its meeting of 23 February 2016, the results of the self-assessment carried out by the Directors of the Company on the operation and composition of the Board of Directors, its Committees and the Shareholders Meeting regarding the financial year 2016, with the Board reporting on its findings. The Committee concluded that, in general terms, the Company's Board Members stated a high degree of satisfaction with the organization and activities of such governing bodies.

Annual Corporate Governance Report 2015.

On a different matter, the Committee reviewed and issued a favourable opinion, at its meeting of the 23 February 2016, on the content of the Telefónica, S.A. Annual Corporate Governance Report for the 2015 financial year, which was adjusted to the model set down in Circular 7/2015, of the 22 December, published by Spain's CNMV This Report was passed by the Company's Board of Directors at its meeting on the 24 February 2016.

Annual Report on Executive Remuneration 2015.

Equally, the Committee studied and issued a favourable opinion on the Report on Executive Remuneration for the year 2015 at its meeting on the 23 February 2016, 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 the 24 February 2016, and in consultative vote by the General Shareholders' Meeting held on 12 May 2016.

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