AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE YEAR ENDED DECEMBER 31, 2015

Independent Audit Report

TELEFÓNICA, S.A.
Financial Statements and Management Report
for the year ended
December 31, 2015

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Translation of a report and financial statements originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails (See Note 24)

INDEPENDENT AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of
Telefónica, S.A.

Report on the financial statements

We have audited the accompanying financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2015, and the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended.

Directors' responsibility for the financial statements

The Directors are responsible for the preparation of the accompanying financial statements so that they give a true and fair view of the equity and financial position and the results of Telefónica, S.A., in accordance with the regulatory framework for financial information applicable to the Entity in Spain, identified in Note 2.a to the accompanying financial statements, and for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the accompanying financial statements based on our audit. We conducted our audit in accordance with prevailing audit regulations in Spain. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of financial statements by the Directors of the Company in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements give a true and fair view, in all material respects, of the equity and financial position of Telefónica, S.A. at December 31, 2015, and its results and cash flow for the year then ended, in accordance with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

Report on other legal and regulatory requirements

The accompanying 2015 management report contains such explanations as the Directors consider appropriate concerning the situation of the Company, the evolution of its business and other matters; however, it is not an integral part of the financial statements. We have checked that the accounting information included in the aforementioned management report agrees with the 2015 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company's accounting records.

ERNST & YOUNG, S.L.

Ignacio Viota del Corte

February 26, 2016

2015

TELEFÓNICA, S.A.

Annual financial statements and management report for the year ended December 31, 2015

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Telefónica, S.A.

Balance sheet at December 31

Millions of euros			
ASSETS	Notes	2015	2014
NON-CURRENT ASSETS		**62,204**	**73,065**
Intangible assets	5	**55**	**58**
Software		8	13
Other intangible assets		47	45
Property, plant and equipment	6	**222**	**225**
Land and buildings		143	142
Plant and other PP&E items		62	76
Property, plant and equipment under construction and prepayments		17	7
Investment property	7	**401**	**417**
Land		94	94
Buildings		307	323
Non-current investments in Group companies and associates	8	**50,300**	**62,367**
Equity instruments		47,971	59,123
Loans to Group companies and associates		2,313	3,227
Other financial assets		16	17
Financial investments	9	**5,073**	**5,709**
Equity instruments		384	483
Loans to third parties		41	217
Derivatives	16	4,638	4,998
Other financial assets	9	10	11
Deferred tax assets	17	**6,153**	**4,289**
CURRENT ASSETS		**22,809**	**12,782**
Net assets held for sale	8	**12,508**	**–**
Trade and other receivables	10	**594**	**1,081**
Current investments in Group companies and associates	8	**7,504**	**5,168**
Loans to Group companies and associates		7,426	5,031
Derivatives	16	40	105
Other financial assets		38	32
Investments	9	**2,060**	**1,941**
Loans to companies		60	1,399
Derivatives	16	1,996	488
Other financial assets		4	54
Accruals		**33**	**8**
Cash and cash equivalents		**110**	**4,584**
TOTAL ASSETS		**85,013**	**85,847**

The accompanying Notes 1 to 24 and Appendix I and II are an integral part of these balance sheets

Millions of euros			
Equity and liabilities	Notes	2015	2014
EQUITY		**23,163**	**23,168**
CAPITAL AND RESERVES		23,953	24,232
Share capital	11	**4,975**	**4,657**
Share premium	11	**3,227**	**460**
Reserves	11	**18,105**	**18,682**
Legal		984	984
Other reserves		17,121	17,698
Treasury shares and own equity instruments	11	**(1,656)**	**(1,587)**
Profit for the year	3	**8**	**2,604**
Interim dividend	3	**(1,912)**	**(1,790)**
Other equity instruments	11	**1,206**	**1,206**
UNREALIZED GAINS (LOSSES) RESERVE	11	(790)	(1,064)
Available-for-sale financial assets		**11**	**20**
Hedging instruments		**(801)**	**(1,084)**
NON-CURRENT LIABILITIES		**46,255**	**49,351**
Non-current provisions	18	**835**	**267**
Non-current borrowings	12	**8,610**	**8,069**
Bonds and other marketable debt securities	13	800	831
Bank borrowings	14	4,825	4,027
Derivatives	16	2,847	3,122
Other debts		138	89
Non-current borrowings from Group companies and associates	15	**36,683**	**40,728**
Deferred tax liabilities	17	**88**	**179**
Long term deferred revenues		**39**	**108**
CURRENT LIABILITIES		**15,595**	**13,328**
Current provisions	18	**43**	**46**
Current borrowings	12	**1,628**	**1,201**
Bonds and other marketable debt securities	13	85	77
Bank borrowings	14	1,269	759
Derivatives	16	274	365
Current borrowings from Group companies and associates	15	**13,217**	**11,702**
Trade and other payables	18	**619**	**336**
Accruals		**88**	**43**
TOTAL EQUITY AND LIABILITIES		**85,013**	**85,847**

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these balance sheets

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2015	2014 (*)
Revenue	19	**5,900**	**7,388**
Rendering of services to Group companies and associates		563	608
Rendering of services to non-group companies		4	3
Dividends from Group companies and associates		5,171	6,670
Interest income on loans to Group companies and associates		162	107
Impairment and gains (losses) on disposal of financial instruments		**(4,457)**	**(1,175)**
Impairment losses and other losses	8	(4,457)	(1,179)
Gains (losses) on disposal and other gains and losses		-	4
Other operating income	19	**91**	**94**
Non-core and other current operating revenue - Group companies and associates		22	23
Non-core and other current operating revenue - non-group companies		69	71
Employees benefits expense	19	**(315)**	**(233)**
Wages, salaries and others		(284)	(203)
Social security costs		(31)	(30)
Other operational expense		**(783)**	**(328)**
External services - Group companies and associates	19	(132)	(105)
External services - non-group companies	19	(624)	(198)
Taxes other than income tax		(27)	(25)
Depreciation and amortization	5, 6 and 7	**(43)**	**(64)**
Gains (losses) on disposal of fixed assets		**17**	**-**
OPERATING PROFIT		**410**	**5,682**
Finance revenue	19	**593**	**184**
Finance costs	19	**(2,804)**	**(2,296)**
Change in fair value of financial instruments		**(19)**	**(57)**
Trading portfolio and other securities		–	(38)
Gain (loss) on available-for-sale financial assets recognized in the period	9 y 11	(19)	(19)
Exchange rate gains (losses)	19	**(102)**	**(103)**
Impairment and gains (losses) on disposal of financial instruments with third-parties	9.3 y 19.9	**426**	**(270)**
NET FINANCIAL EXPENSE		**(1,906)**	**(2,542)**
PROFIT BEFORE TAX	21	**(1,496)**	**3,140**
Income tax	17	**2,102**	**698**
PROFIT FOR THE YEAR CONTINUED OPERATIONS		**606**	**3,838**
Discontinued operations net of taxes	2 y 22	**(598)**	**(1,234)**
PROFIT FOR THE YEAR		**8**	**2,604**

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these income statements
(*) Revised data see Note 2

Telefónica, S.A.

Statements of changes in equity for the years ended December 31

A) Statement of recognized income and expense

Millions of euros	Notes	2015	2014
Profit of the period		**8**	**2,604**
Total income and expense recognized directly in equity	11	**580**	**(360)**
From measurement of available-for-sale financial assets		467	(59)
From cash flow hedges		380	(411)
Income tax impact		(267)	110
Total amounts transferred to income statement	11	**(306)**	**127**
From measurement of available-for-sale financial assets		(481)	19
From cash flow hedges		56	163
Income tax impact		119	(55)
TOTAL RECOGNIZED INCOME AND EXPENSE		**282**	**2,371**

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these statements of changes in equity.

B) Statements of total changes in equity for the years ended December 31

Millions of euros	Share capital	Share premium and Reserves	Treasury shares	Profit for the year	Interim dividend	Other net equity instruments	Net unrealized gains (losses) reserve	Total
Balance at December 31, 2013	**4,551**	**18,988**	**(545)**	**664**	**–**	**–**	**(831)**	**22,827**
Total recognized income and expense	–	–	–	2,604	–	–	(233)	2,371
Transactions with shareholders and owners	106	(485)	(1,042)	–	(1,790)	1,206	–	(2,005)
Dividends paid (Note 11)	106	(348)	–	–	(1,790)	–	–	(2,032)
Transactions with treasury shares or own equity instruments (net)	–	(113)	(1,042)	–	–	–	–	(1,155)
Other transactions with shareholders and owners	–	(24)	–	–	–	1,206	–	1,182
Other movements	–	(25)	–	–	–	–	–	(25)
Appropriation of prior year profit (loss)	–	664	–	(664)	–	–	–	–
Balance at December 31, 2014	**4,657**	**19,142**	**(1,587)**	**2,604**	**(1,790)**	**1,206**	**(1,064)**	**23,168**
Total recognized income and expense	–	–	–	8	–	–	274	282
Transactions with shareholders and owners	318	1,374	(69)	–	(1,912)	–	–	(289)
Capital increases (Note 11)	281	2,726	–	–	–	–	–	3,007
Capital decreases (Note 11)	(74)	(812)	886	–	–	–	–	–
Dividends paid (Note 11)	111	(448)	–	–	(1,912)	–	–	(2,249)
Transactions with treasury shares or own equity instruments (net)	–	(75)	(1,510)	–	–	–	–	(1,585)
Other transactions with shareholders and owners	–	(17)	555	–	–	–	–	538
Other movements	–	2	–	–	–	–	–	2
Appropriation of prior year profit (loss)	–	814	–	(2,604)	1,790	–	–	–
Balance at December 31, 2015	**4,975**	**21,332**	**(1,656)**	**8**	**(1,912)**	**1,206**	**(790)**	**23,163**

The accompanying Notes 1 to 24 and Appendices I and II are an integral part of these statements of changes in equity.

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	Notes	2015	2014 (*)
A) CASH FLOWS FROM OPERATING ACTIVITIES		**2,421**	**8,418**
Profit before tax		**(1,496)**	**3,140**
Adjustments to profit:		**1,137**	**(3,025)**
Depreciation and amortization	5,6 and 7	43	64
Impairment of investments in Group companies and associates	8	4,457	1,179
Change in long term provisions		81	(29)
Gains on the sale of financial assets		5	(4)
Losses on disposal of property, plant and equipment		(22)	-
Dividends from Group companies and associates	19	(5,171)	(6,670)
Interest income on loans to Group companies and associates	19	(162)	(107)
Net financial expense		1,906	2,542
Change in working capital		**370**	**81**
Trade and other receivables		165	73
Other current assets		(26)	(40)
Trade and other payables		222	(49)
Other current liabilities		9	97
Other cash flows from operating activities	21	**2,410**	**8,222**
Net interest paid		(1,831)	(1,872)
Dividends received		3,091	9,750
Income tax receipts		1,150	237
Other payments/proceeds from operating activities		-	107
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES		**(2,848)**	**(3,024)**
Payments on investments	21	(4,915)	(5,704)
Proceeds from disposals	21	2,067	2,680
C) CASH FLOWS USED IN FINANCING ACTIVITIES		**(4,031)**	**(5,524)**
Payments on equity instruments		(1,615)	(21)
Proceeds from financial liabilities	21	(3,227)	(3,502)
Debt issues		8,465	10,038
Repayment and redemption of debt		(11,692)	(13,540)
Capital increase		3,048	-
Dividends paid	21	(2,237)	(2,001)
D) NET FOREIGN EXCHANGE DIFFERENCE		**(16)**	**(54)**
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**(4,474)**	**(184)**
Cash and cash equivalents at January 1		4,584	4,768
Cash and cash equivalents at December 31		110	4,584

Notes 1 to 24 and Appendices I and II are an integral part of these cash flow statements.
(*) Revised data see Note 2

TELEFÓNICA, S.A.

Annual financial statements for the ended December 31, 2015

Note 1. Introduction and general information

Telefónica, S.A. (“Telefónica” or “the Company”) is a public limited company incorporated for an indefinite period on April 19, 1924, under the corporate name of Compañía Telefónica Nacional de España, S.A. It adopted its present name in April 1998.

The Company’s registered office is at Gran Vía 28, Madrid (Spain), and its Employer Identification Number (CIF) is A-28/015865.

Telefónica’s basic corporate purpose, pursuant to Article 4 of its Bylaws, is the provision of all manner of public or private telecommunications services, including ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

In keeping with the above, Telefónica is currently the parent company of a group that offers both fix and mobile telecommunications with the aim to turn the challenges of the new digital business into reality and being one of the most important players. The objective of the Telefonica Group is positioning as a Company with an active role in the digital business taking advantage of the opportunities of its size and industrial and strategic alliances.

The Company is taxed under the general tax regime established by the Spanish State, the Spanish Autonomous Communities and local governments, and files consolidated tax returns with most of the Spanish subsidiaries of its Group under the consolidated tax regime applicable to corporate groups.

Note 2. Basis of presentation

a) True and fair view

These financial statements have been prepared from Telefónica, S.A.'s accounting records by the Company's Directors in accordance with the accounting principles and standards contained in the Spanish GAAP in force approved by Royal Decree 1514/2007, on November 16 (PGC 2007), modified by Royal Decree 1159/2010, dated September 17, 2010 and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company's equity, financial position, results of operations and of the cash flows obtained and applied in 2015.

The accompanying financial statements for the year ended December 31, 2015 were prepared by the Company's Board of Directors at its meeting on February 24, 2016 for submission for approval at the General Shareholders' Meeting, which is expected to occur without modification.

The figures in these financial statements are expressed in millions of euros, unless indicated otherwise, and therefore may be rounded. The euro is the Company's functional currency.

b) Comparison of information

In 2014 and 2015 there have not been significant transactions that should be taken into account in order to ensure the comparison of information included in the Annual Financial Statements of both years.

As a consequence of the sale agreement signed on March, 24, 2015 between Telefónica, S.A. and Hutchison 3G UK Investment Limited and Hutchison 3G UK Holdings (CI) Limited (together, "Hutchison") and according to PGC 2007 Valuation Rule Nº 7, 11 caption, the amounts included in 2014 figures of the different captions of the profit and loss accounts referred to transactions with UK affiliates have been revised for comparative purposes as they are significant from a geographical area point of view (see Note 22).

Profit and loss caption (Millions of euros)	Approved 12/31/2014	Revision	Revised 12/31/2014
Rendering of services to Group companies	643	(35)	608
Dividends from Group companies and associates	7,974	(1,304)	6,670
Other operating income Group companies	25	(2)	23
Impairment losses	(3,679)	2,500	(1,179)
Financial expenses Group companies	(104)	(1)	(105)
Exchange rate losses	(96)	(7)	(103)
Income Tax	615	83	698
Discontinuated operations net of taxes (Note 22)	-	1,234	(1,234)

c) Materiality

These financial statements do not include any information or disclosures that, not requiring presentation due to their qualitative significance, have been determined as immaterial or of no relevance pursuant to the concepts of *materiality* or *relevance* defined in the PGC 2007 conceptual framework.

d) Use of estimates

The financial statements have been prepared using estimates based on historical experience and other factors considered reasonable under the circumstances. The carrying value of assets and liabilities, which is not readily apparent from other sources, was established on the basis of these estimates. The Company periodically reviews these estimates.

A significant change in the facts and circumstances on which these estimates are based could have an impact on the Company's results and financial position.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the financial statements of the following year are discussed below.

Provisions for impairment of investments in Group companies and associates

Investments in group companies, joint ventures and associates are tested for impairment at each year end to determine whether an impairment loss must be recognized in the income statement or a previously recognized impairment loss be reversed. The decision to recognize an impairment loss (or a reversal) involves estimates of the reasons for the potential impairment (or recovery), as well as the timing and amount. In note 8.2 it is assessed the impairment of these investments.

There is a significant element of judgment involved in the estimates required to determine recoverable amount and the assumptions regarding the performance of these investments, since the timing and scope of future changes in the business are difficult to predict.

Deferred taxes

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

The appropriate valuation of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation or unforeseen transactions that could affect tax balances. The information about deferred tax assets and unused tax credits for loss carryforwards, whose effect has been registered when necessary in balance, is included in Note 17.

Note 3: Proposed appropriation of profit

Telefónica, S.A. obtained 8 million euros of profit in 2015. Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2015 profit for approval at the Shareholders' Meeting:

Millions of euros

Proposed appropriation:	
Profit for the year	8
Distribution to:	
Goodwill reserve (Note 11.1.c)	2
Legal reserve	1
Interim Dividend	5

At its meeting of April 29, 2015, the Company's Board of Directors resolved to pay an interim dividend against 2015 profit of a fixed gross 0.40 euros for each of the outstanding shares carrying dividend rights. This dividend was paid in full on May 12, 2015. The total amount paid was 1,912 million euros (see Note 11.1.d).

In accordance with Article 277 of the Spanish Companies Law, the following table shows the provisional statement issued by the Directors to substantiate that the Company had sufficient liquidity at that time to distribute this dividend.

Millions of euros

Liquidity statement	
Income from January 1 through March 31, 2015	2,201
Mandatory appropriation to reserves	–
Distributable income	2,201
Proposed interim dividend (maximum amount)	(1,975)
Cash position	
Funds available for distribution	
Cash and cash equivalents	3
Unused credit facilities	9,314
Proposed interim dividend (maximum amount)	(1,975)

Telefónica, S.A.'s Board of Directors also proposes for approval at the Shareholders' Meeting that the difference between the distributable profit of year 2015 and interim dividend is registered against voluntary reserves in the amount of 1,907 million euros.

Note 4. Recognition and measurement accounting policies

As stated in Note 2, the Company's financial statements have been prepared in accordance with the accounting principles and standards contained in the Código de Comercio, which are further developed in the Plan General de Contabilidad currently in force (PGC 2007), as well as any commercial regulation in force at the reporting date.

Accordingly, only the most significant accounting policies used in preparing the accompanying financial statements are set out below, in light of the nature of the Company's activities as a holding.

a) Intangible assets

Intangible assets are stated at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

Intangible assets are amortized on a straight-line basis over their useful lives. The most significant items included in this caption are computer software licenses, which are generally amortized on a straight-line basis over three years.

b) Property, plant and equipment and investment property

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value.

The Company depreciates its property, plant and equipment once the assets are in full working conditions using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

Estimated useful life	Years
Buildings	40
Plant and machinery	3 - 25
Other plant or equipment, furniture and fixtures	10
Other items of property, plant and equipment	4 - 10

Investment property is measured and depreciated using the same criteria described for land and buildings for own use.

c) Impairment of non-current assets

Non-current assets are assessed at each reporting date for indicators of impairment. Where such indicators exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset's recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value, using a discount rate reflecting current market assessments of the time value of money and the risks specific to the asset.

Telefónica bases the calculation of impairment on the business plans of the various companies approved by the Board of Directors' of Telefónica, S.A.to which the assets are allocated. The projected cash flows, based on strategic business plans, cover a period of five years not including the present year when the analysis is calculated. Starting with the sixth year, an expected constant growth rate is applied.

d) Financial assets and liabilities

Financial investments

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset.

"Investments in group companies, joint ventures and associates" are classified into a category of the same name and are shown at cost less any impairment loss (see Note 4.c). Group companies are those over which the Company exercises control, either by exercising effective control or by virtue of agreements with the other shareholders. Joint ventures are companies which are jointly controlled with third parties. Associates are companies in which there is significant influence, but not control or joint control with third parties. Telefónica assesses the existence of significant influence not only in terms of percentage ownership but also in qualitative terms such as presence on the board of directors, involvement in decision-making, the exchange of management personnel, and access to technical information.

Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest rate movements and which have not been included in the other categories of financial assets defined in the PGC 2007 are classified as available-for-sale. These investments are recorded under "Non-current assets," unless it is probable and feasible that they will be sold within 12 months.

Derivative financial instruments and hedge accounting

When Telefónica chooses not to apply hedge accounting criteria but economic hedging, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

e) Revenue and expenses

Revenue and expenses are recognized on the income statement based on an accruals basis; i.e. when the goods or services represented by them take place, regardless of when actual payment or collection occurs.

The income obtained by the Company in dividends received from Group companies and associates, and from the interest accrued on loans and credits given to them, are included in revenue in compliance with the provisions of consultation No. 2 of BOICAC 79, published on September 30, 2009.

f) Related party transactions

In mergers and spin-offs of businesses involving the parent company and its direct or indirect subsidiary, in cases of non-monetary contributions of businesses between Group companies, and in cases of dividends, the contributed assets are valued, in general, at their pre-transaction carrying amount in the individual financial statements, given that the Telefónica Group does not prepare its consolidated financial statements in accordance with the Standards on Preparing Consolidated Financial Statements (Spanish "NOFCAC").

In these same operations, companies may also opt to use the consolidated values under International Financial Reporting Standards (IFRS) as adopted by the European Union, providing that the consolidated figures do not differ from those obtained under the NOFCAC. Lastly, the Company may also opt to use the values resulting from a reconciliation to the NOFCAC. Any accounting difference is taken to reserves.

g) Financial guarantees

The Company has provided guarantees to a number of subsidiaries to secure their transactions with third parties (see Note 20.a). Where financial guarantees provided have a counterguarantee on the Company's balance sheet, the value of the counterguarantee is estimated to be equal to the guarantee given, with no additional liability recognized as a result.

Guarantees provided for which there is no item on the Company's balance sheet acting as a counterguarantee are initially measured at fair value which, unless there is evidence to the contrary, is the same as the premium received plus the present value of any premiums receivable. After initial recognition, these are subsequently measured at the higher of:

i) The amount resulting from the application of the rules for measuring provisions and contingencies.

ii) The amount initially recognized less, when applicable, any amounts take to the income statement corresponding to accrued income.

h) Consolidated data

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group's consolidated financial statements for 2015 and 2014 are as follows:

Millions of euros

Item	2015	2014
Total assets	122,974	122,348
Equity:		
Attributable to equity holders of the parent	17,891	21,135
Attributable to minority interests	9,665	9,186
Revenue from operations	47,219	43,458
Profit for the year:		
Attributable to equity holders of the parent	2,745	3,001
Attributable to minority interests	135	251

Note 5. Intangible assets

The movements in the items composing intangible assets and the related accumulated amortization in 2015 and 2014 are as follows:

2015

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	**274**	**8**	**(30)**	**2**	**254**
Software	129	2	–	1	132
Other intangible assets	145	6	(30)	1	122
ACCUMULATED AMORTIZATION	**(216)**	**(13)**	**30**	**–**	**(199)**
Software	(116)	(8)	–	–	(124)
Other intangible assets	(100)	(5)	30	–	(75)
Net carrying amount	**58**	**(5)**	**–**	**2**	**55**

2014

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	**261**	**10**	**–**	**3**	**274**
Software	120	5	–	4	129
Other intangible assets	141	5	–	(1)	145
ACCUMULATED AMORTIZATION	**(203)**	**(13)**	**–**	**–**	**(216)**
Software	(108)	(8)	–	–	(116)
Other intangible assets	(95)	(5)	–	–	(100)
Net carrying amount	**58**	**(3)**	**–**	**3**	**58**

At December 31, 2015 and 2014 commitments exist to acquire intangible assets amounting to 0.2 and 0.7 million euros, respectively.

At December 31, 2015 and 2014, the Company had 164 million euros and 175 million euros, respectively, of fully amortized intangible assets.

Note 6. Property, plant and equipment

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2015 and 2014 are as follows:

2015

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	**557**	**24**	**(7)**	**(2)**	**572**
Land and buildings	228	8	(4)	–	232
Plant and other PP&E items	322	3	(2)	–	323
Property, plant and equipment under construction and prepayments	7	13	(1)	(2)	17
ACCUMULATED DEPRECIATION	**(332)**	**(20)**	**2**	**–**	**(350)**
Buildings	(86)	(3)	–	–	(89)
Plant and other PP&E items	(246)	(17)	2	–	(261)
Net carrying amount	**225**	**4**	**(5)**	**(2)**	**222**

2014

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	**567**	**6**	**(13)**	**(3)**	**557**
Land and buildings	228	–	–	–	228
Plant and other PP&E items	313	3	–	6	322
Property, plant and equipment under construction and prepayments	26	3	(13)	(9)	7
ACCUMULATED DEPRECIATION	**(305)**	**(40)**	**13**	**–**	**(332)**
Buildings	(82)	(17)	13	–	(86)
Plant and other PP&E items	(223)	(23)	–	–	(246)
Net carrying amount	**262**	**(34)**	**–**	**(3)**	**225**

Firm commitments to acquire property, plant and equipment at December 31, 2015 and 2014 amounted to 1 million euros and 3 million euros, respectively. At December 31, 2015 and 2014, the Company had 178 million euros and 139 million euros, respectively, of fully depreciated items of property, plant and equipment.

Telefónica, S.A. has taken out insurance policies with appropriate limits to cover the potential risks which could affect its property, plant and equipment.

"Property, plant and equipment" includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 68 million euros and 74 million euros at the 2015 and 2014 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) of 37 and 48 million euros at December 31, 2015 and 2014, respectively. The land and buildings rented to other Group Companies have been included as "Investment properties" in Note 7.

Note 7. Investment properties

The movements in the items composing investment properties in 2015 and 2014 and the related accumulated depreciation are as follows:

2015

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	**499**	**-**	**(13)**	**-**	**486**
Land	94	-	-	-	94
Buildings	405	-	(13)	-	392
ACCUMULATED DEPRECIATION	**(82)**	**(10)**	**7**	**-**	**(85)**
Buildings	(82)	(10)	7	-	(85)
Net carrying amount	**417**	**(10)**	**(6)**	**-**	**401**

2014

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	**470**	**29**	**-**	**-**	**499**
Land	65	29	-	-	94
Buildings	405	-	-	-	405
ACCUMULATED DEPRECIATION	**(71)**	**(11)**	**-**	**-**	**(82)**
Buildings	(71)	(11)	-	-	(82)
Net carrying amount	**399**	**18**	**-**	**-**	**417**

As of September 4th, 2014 the Company exerted its pre-emptive rights and acquired the building of its headquarters in Barcelona, known as “Diagonal 00”, for 107 million euros plus transaction taxes. Until the purchase moment, the building was registered as an asset in financial leasing and the liability associated with this transaction amounted to 79.5 million euros. Having examined it, the Company estimated that the additional investment corresponded only to a higher value of land, so the difference between liability and purchase cost was booked as addition under the “Land” caption.

In addition to the “Diagonal 00” building mentioned above, “Investment properties” mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the Distrito Telefónica head offices in Madrid.

In October 2015 the sale of the building addressed in Don Ramón de la Cruz street (Madrid) was completed. This building had been rented as a whole to other Group companies. The profit from the sale of the asset amounting to 22 million euros has been booked as “Profit from the sale of fixed assets” in the profit and loss account.

In 2015, the Company has buildings with a total area of 328,314 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 93.27% of the buildings it has earmarked for lease. In 2014, it had a total of 322,039 square meters leased, equivalent to an occupancy rate of 92.81% of the buildings earmarked for lease.

Total income from leased buildings in 2015 (see Note 19.1) amounted to 48 million euros (49 million euros in 2014). Future minimum rentals receivable under non-cancellable leases are as follows:

	2015	2014

Millions of euros	Future minimum recoveries	Future minimum recoveries
Up to one year	44	48
Between two and five years	9	17
Over 5 years	1	1
Total	**54**	**66**

The most significant lease contracts held with subsidiaries occupying Distrito Telefónica have been renewed in 2015 for a non-cancellable period of 12 months. The figures also include non-cancellable lease revenue from Diagonal 00, the contracts for which expire in July 2016.

The main contracts of operating leases in which Telefónica, S.A. acts as lessee and there is no sub-lease are described in Note 19.5.

Note 8. Investments in group companies and associates

8.1. The movements in the items composing investments in Group companies, joint ventures and associates in 2015 and 2014 are as follows:

2015

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Equity instruments (Net) (1)	59,123	2,354	(340)	(13,166)	–	–	–	47,971	110,470
Equity instruments (Cost)	82,005	6,811	(340)	(26,294)	–	–	–	62,182	
Impairment losses	(22,882)	(4,457)	–	13,128	–	–	–	(14,211)	
Loans to Group companies and associates	3,227	124	(202)	(795)	(41)	–	–	2,313	2,337
Other financial assets	17	18	–	(19)	–	–	–	16	16
Total non-current investment in Group companies and associates	**62,367**	**2,496**	**(542)**	**(13,980)**	**(41)**	**–**	**–**	**50,300**	**112,823**
Loans to Group companies and associates	5,031	4,779	(3,108)	795	(71)	–	–	7,426	7,438
Derivates	105	40	(105)	–	–	–	–	40	40
Other financial assets	32	19	(32)	19	–	–	–	38	38
Total current investments in Group companies and associates	**5,168**	**4,838**	**(3,245)**	**814**	**(71)**	**–**	**–**	**7,504**	**7,516**

(1) Fair value at December 31, 2015 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

2014

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Equity instruments (Net) (1)	58,155	3,549	–	(2,727)	–	(2)	148	59,123	131,415
Equity instruments (Cost)	80,107	4,728	–	(2,976)	–	(2)	148	82,005	
Impairment losses	(21,952)	(1,179)	–	249	–	–	–	(22,882)	
Loans to Group companies and associates	4,205	801	(12)	(1,789)	22	–	–	3,227	3,335
Other financial assets	20	14	–	(17)	–	–	–	17	17
Total non-current investment in Group companies and associates	**62,380**	**4,364**	**(12)**	**(4,533)**	**22**	**(2)**	**148**	**62,367**	**134,767**
Loans to Group companies and associates	5,956	4,302	(5,723)	482	14	–	–	5,031	5,031
Derivates	10	311	(216)	–	–	–	–	105	105
Other financial assets	26	19	(30)	17	–	–	–	32	32
Total current investments in Group companies and associates	**5,992**	**4,632**	**(5,969)**	**499**	**14**	**–**	**–**	**5,168**	**5,168**

(1) Fair value at December 31, 2014 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

The most significant transactions occurred in 2015 and 2014 as well as their accounting impacts are described below:

2015

On March 24, 2015 Telefónica, S.A. signed an agreement with Hutchison to acquire Telefónica's operations in the UK. As detailed in Notes 2 and 22, since the agreement date, the net carrying amount of the investment in Telefónica Europe, plc. subject to the transaction (13,189 million euros) was reclassified under "Non-current assets held for sale". The investment write off in 2015 has been included under the same balance sheet caption amounting to 852 million euros (note 22). The write off adjustment in the income statements ended December 31, 2015 have been recognized under "Profit after tax from discontinued operations". 2014 figure amounting to 2,500 million euros has been accordingly reclassified to the same caption.

Once the pertinent regulatory authorizations were obtained on April 27, 2015, and with the aim of raising the funds needed to complete the acquisition of Global Village Telecom, S.A. and its parent company GVT Participaçoes, S.A. the General Shareholdings' Meeting of Telefônica Brasil, S.A. launched a capital increase of 15,812 million reales. Telefónica, S.A. subscribed 3,995 million reales (equivalent to 1.262 million euros). On the same date, and with the object of subscribing the above mentioned capital increase, SP Telecomunicaçoes Participaoes, Ltda approved a capital increase of 3,223 million reales. Telefónica, S.A. paid 1,270 million reales (equivalente to 401 million euros).

On June 24, 2015 and in compliance with the undertakings assumed in the agreement entered into for the acquisition of Global Village Telecom, S.A. (GVT), it has, through its 100% subsidiary Telco TE S.p.A., delivered 1,110 million ordinary shares of Telecom Italia S.p.A. (representing 8.2% of its ordinary shares) to Vivendi, S.A. and has received from Vivendi, S.A. all the ordinary shares and part of the preferred shares of Telefônica Brasil S.A. that Vivendi S.A.received as consideration for the sale of GVT, which together represent 4.5% of the total share capital of Telefônica Brasil S.A.The fair value of Telecom Italia shares contributed to Vivendi has been calculated using the quoted price at the approval date amounting to 1,264 million euros. This same amount has been used to value the 4.5% additional investment in Telefônica Brasil, S.A.

On July 29, 2015, Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica has committed to deliver 46 million of its treasury shares in exchange for 58.4 million of Telefônica Brasil, S.A. shares, representing aproximately 3.5% of the share capital of Telefônica Brasil, S.A. The execution of the agreement was performed on September 16, 2015 and valued at the quoted price of Telefónica's shares at that date, 538 million euros.

As a consequence of the aforementioned transactions, the direct stake of Telefónica, S.A. in Telefônica Brasil, S.A. was increased to 29.77% and the stake at SP Telecommunicaçoes Participaçoes, Ltda is 39.4% of its capital.

On June 18, 2015 the public deed of Telco, S.p.A.'s spin off transaction was filed to the Companies Register. As a result of the process, Telecom Italia, S.p.A. ordinary shares owned by Telco, S.p.A. (equivalent to a 22.3% of the company's share capital) were transferred to its stakeholders. Therefore, Telefónica, S.A. through a 100% owned newly incorporated subsidiary, Telco TE, S.p.A. received ordinary shares representing 14.72% of Telecom Italia's share capital. In this same spin off process, Telco TE, S.p.A. registered the part of the liability that Telco, S.p.A. owed its stakeholders, pro-rata their percentage of ownership. The net book value of assets and liabilities registered was 603 million euros and it is included as "additions" in the table of movements above (Note 9.3.).

On the other hand, Telco TE S.p.A. entered into a purchase agreement with a financing institution for the sale of 872 million ordinary shares of Telecom Italia S.p.A., representing 6.5% of the ordinary shares of this company, for an amount of 1,025 million euros.

Likewise, Telefónica has arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia S.p.A., issued by Telefónica, S.A. in July 2014.

Telefónica, S.A. has therefore ended the divesting process of its indirect stake at Telecom Italia, S.p.A., in accordance with the regulatory and competence requirements.

2014

On January 28th, 2014 Telefónica announced that after obtaining the relevant regulatory approval, the sale transaction of the 65.9% of the capital share of Telefónica Czech Republic, a.s. to PPF Group N.V.I. was completed. This concept was registered in 2013 balance under caption "Non-current assets held for sale" for an amount of 2,302 million euros.

On June 16, 2014 the three Italian shareholders of Telco, S.p.A. requested the initiation of the process of "demerger" (spin off) of the company, as provided in the Shareholders Agreement. Implementation of the demerger, approved by the General Meeting of Shareholders of Telco, S.p.A. held on July 9, 2014, was approved in 2015 by anti-trust and telecommunications authorities (including Brazil and Argentina).

At a meeting on December 22, 2014, the Brazilian telecommunications regulator (ANATEL) approved the demerger on condition of suspension of Telefónica's voting rights in Telecom Italia, S.p.A. and its subsidiaries, among certain other measures. Telefónica agreed with the aforementioned suspension of voting rights and offered the presentation of a formal statement to ANATEL in this regard. Therefore, on the same date Telefónica ceased to have significant influence through its indirect holding in Telecom Italia, S.p.A. and reclassified this investment as an available-for-sale financial asset (see Note 9).

<u>Other movements</u>

Movement in "Transfers" in both 2015 and 2014 mainly includes the reclassification between long-term and current loans in accordance with the loan maturity schedule, as well as the reclassification under "Loans to third parties" of the bond and not yet due accrued interest of Telco, S.p.A.

In 2015 "Transfers" figure under the caption of "Equity Instruments" mainly corresponds to the reclassification of the net carrying amount of the investment in Telefónica Europe, plc as stated at the beginning of the Note amounting to 13,189 million euros. In addition, as of December 31, 2015, the Company has reached an agreement to sell its affiliated company Telefónica Gestión de Servicios Compartidos España, S.A.U. Therefore, the net carrying amount of this investment has also been included as "Held for sale assets" amounting to 8 million euros. On the other hand, the increase of the negative carrying amount of certain investments has been reclassified to the caption "Long Term Accruals" (31 million euros).

In 2014, movement in "Transfers" in "Equity instruments" caption refers to the net book value reclassification of the investment in Telco,S.p.A. (amounting to 358 million euros). Offsetting this figure, it is also included the reclassification to "Long term provisions" of the negative net book value of some investments in group companies totaling 131 million euros.

In 2015 and 2014, Telefónica, S.A. bought and sold the following shareholdings:

a) Acquisitions of investments and capital increases (Additions):

Millions of euros Companies	2015	2014
Telefônica Brasil, S.A.	3,064	-
Sao Paulo Telecommunicaçoes, S.A.	401	-
Telefónica Internacional, S.A.U.	2,157	-
Telfin Ireland, Ltd.	-	3,700
Telefónica de Contenidos, S.A.U.	-	400
Telefónica Digital Holdings, S.A.U.	399	268
Telefónica Finanzas México, S.A. de C.V.	-	138
Telco TE, S.p.A.	603	-
Telefónica Móviles México, S.A. de C.V.	110	56
Other companies	77	166
Total	**6,811**	**4,728**

2015

Transactions referring the investment increase in Telefônica Brasil, S.A. and Sao Paulo Telecommunicaçoes, S.A. have been detailed at the beginning of this Note.

On June 25, 2015 Telefónica Internacional, S.A.U. made a capital increase with share premium reserve amounting to 2,157 million euros totally subscribed and paid by the Company.

With the object of regaining equity balance, on February 26, 2015 Telefónica Digital Holding, S.A. increased its share capital subscribed in full with a loan capitalization of 156 million euros and proceeds in cash amounting to 175 million euros. Moreover, on November 18, 2015 and with the aim of enabling the fulfillment of its financing needs, the company has executed a capital increase of 68 million euros subscribed and paid in full by Telefónica, S.A.

The amount in the above chart regarding Telco TE, S.p.A. has been explained at the beginning of the Note.

In order to provide Telefónica México, S.A. de C.V. with the funds needed to cancel short term payments, in November and December the subsidary has made several capital increases amounting to 2,000 million mexican pesos (110 million euros) fully subscribed and paid by its sole stakeholder, Telefónica, S.A.

2014

With the object of regaining equity balance, on January 16th, 2014 Telefónica Digital Holding, S.A.U. increased its share capital totally subscribed and paid by Telefónica, S.A. amounting 31 million euros. On October 2nd, 2014 an additional capital increase was completed totaling 237 million euros also totally subscribed and paid by Telefónica, S.A. with the same objective of regaining the equity balance of the company and its affiliates.

On January 22nd, 2014 Telefónica México, S.A. de C.V. completed a share capital increase amounting to 1,000 million Mexican pesos (56 million euros) fully subscribed by Telefónica, S.A.

On March 25, 2014 Telefónica Finanzas México, S.A. de C.V. has increased its share capital by 2,500 million Mexican pesos (138 million euros) fully subscribed and paid by Telefónica, S.A.

On July 7th, 2014, and within the framework of the purchase of the shares that Promotora de Informaciones, S.A. (PRISA) owns in Distribuidora de Televisión Digital, S.A. (DTS), Telefónica de Contenidos, S.A. increased its share capital in 300 million euros totally subscribed by Telefónica, S.A. With the aim of raising the funds needed to complete the acquisition of this investment once the relevant regulatory approvals are achieved, on November 17th, the company increased its share capital in 100 million euros, fully subscribed and paid by Telefónica, S.A.

On August 1st and September 18th, Telefónica, S.A. completed two capital increases fully subscribed and paid in Telfin Ireland, Ltd totaling 2,900 million and 800 million euros, respectively, in order to provide the company with the funds needed to fulfill borrowing activities for other subsidiaries of the Telefónica Group such as Telefónica Deutschland and carry out their activities.

b) Disposals of investments and capital decreases:

The disposal in 2015 refers to the decrease and pay back of the share premium reserve of Phenix Investments, S.A. In 2014 there were no disposals.

8.2. Assessment of impairment of investments in group companies, joint ventures and associates

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions), considering the percentage of ownership in each subsidiary and translated to euros at the official closing rate of each currency at December 31.

As a result of these estimations and the effect of the net investment hedge in 2015, an impairment provision of 4,457 million euros was recognized (1,179 million euros in 2014). This amount derives mainly from the following companies:

(a) write down of 1,872 million euros for Telefônica Brasil, S.A. (559 million euros in 2014) and 753 million euros for Sao Paulo Telecomunicaçoes, S.A. (176 million euros in 2014).

(b) write down of 233 million euros for Telefónica México, S.A. de C.V. (126 million euros in 2014).

(c) write down of 1,142 million euros for Telefónica Internacional, S.A.U., mainly originated by the impact in this subsidiary's investments of the valuation of its 36,01% stake in Telefônica Brasil, S.A.

(d) write down of 123 million euros for Telcel, C.A. with no amount in 2014.

(e) write down of 267 million euros for Telefónica Digital Holding, S.A.U. (300 million euros in 2014).

The impairment provision in Telefónica Europe, plc is shown, in both 2015 and 2014 as indicated in Note 2 under the caption "Discontinued operations" (Note 22).

The valuation of Telefônica Brasil, S.A. and Sao Paulo Telecomunicaçoes, S.A. was bolstered by the acquisition of GVT in 2015. However, the improvement in operating numbers was significantly impacted by the financial volatility resulting from the country's medium-term economic and political uncertainties.

These economic and financial tensions were felt mainly in the discount rate. As a result, the cost of capital in Brazil increased by 1 p.p. vs. 2014, in line with analysts' expectations. This increase is the result of both higher costs of capital, mainly explained by the increase in the country's risk premium, and higher costs of external finance. The performance of the Brazilian real also generated significant exchange rate losses in 2015, with a 32% depreciation of the currency compared to 2014.

With regard to the full-year growth rate for 2015 (5%), this was not significantly different to that applied in 2014, in line with the analysts' consensus; a conservative approach has also been taken, considering that this rate is consistent with the Brazilian Central Bank's medium-term inflation target (4.5%, within a band of ±2 p.p.), being below the consensus inflation rate expected by analysts over the Strategic Plan horizon (around 6%) and also lower than the forecast nominal GDP growth rate (around 7%). Conservative hypothesis have been used in accordance with analysts consensus.

Turning to the operational side, OIBDA margins over the Strategic Plan horizon have shown an average 1.5 p.p. improvement compared to last year's forecasts. This performance, together with the OIBDA margin used for full-year growth (36%) and the investment rate required for long-term business continuity (16.3%) agrees with analysts' forecasts. Moreover, the synergies deriving from the acquisition of GVT have been incorporated within the time range of the cash flow projections into the valuation, considering both incremental increases in revenues and estimated savings over the coming years.

8.3. The detail of subsidiaries and associates is shown in Appendix I.

8.4. Transactions protected for tax purposes

Transaction carried out in 2015 that qualify for special tax treatment, as defined in Articles 83 or 94, as applicable, of Chapter VIII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, is detailed in the following paragraph. Transactions qualified for special tax treatment carried out in prior years are disclosed in the financial statements for those years.

On July 29, 2015, Telefónica, S.A. as sole stakeholder of Telefónica Gestión de Servicios Compartidos España, S.A.U., decided to partially spin off (with an effect in its share capital and reserves decrease) the activity of major investment management, and its contribution to a newly incorporated company named Telefónica Servicios Globales, S.L. On December 15, 2015 both spin off deed and new incorporation deed were filed in the Madrid Companies Register. Telefónica, S.A. as sole stakeholder of the spinned off subsidiary, has booked the investment in the new company by the net carrying amount of the assets transferred (14 million euros).

On May 25, 2015, Telefónica, S.A., the sole stakeholder of Taetel, S.L.U., resolved to approve the merger of this company with Venturini España, S.A.U. and Compañía de Inversiones y Teleservicios, S.A.U. The takeover merger deed was filed in the Madrid Companies Register on July, 16th 2015. Telefónica, S.A. has booked the increase of the investment in Taetel, S.L.U., at the net carrying amount of the two merged companies, Venturini España, S.A.U. (4 million euros) and Compañía de Inversiones y Teleservicios, S.A.U. (126 million euros).

On July 22, 2015, Telefónica de España, S.A.U., as sole stakeholder of Movistar Loyalty, S.L.U. resolved the merger of the company with the subsequent liquidation and and transfer *en bloc* of its assets and liabilities to Telefónica de España, S.A.U.., which will also acquires all its rights and obligations by universal succession. The takeover merger deed was filed in the Madrid Companies Register on October 6, 2015.

8.5. The breakdown and maturity of loans to Group companies and associates in 2015 and 2014 are follows:

2015

Millions of euros

Company	2016	2017	2018	2019	2020	2021 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	710	–	400	–	–	–	1,110
Telefónica Móviles México, S.A. de C.V.	255	623	–	–	–	–	878
Telefónica de Contenidos, S.A.U.	419	–	–	–	–	–	419
Telefónica de España, S.A.U.	371	165	–	550	–	–	1,086
Telefónica Global Technology, S.A.U.	18	–	–	17	68	97	200
Telfin Ireland, Ltd.	455	–	–	–	–	–	455
Telefónica Internacional, S.A.U.	3,632	–	–	–	–	–	3,632
Telefónica Latinoamerica Holding, S.L.	1,039	–	–	–	–	–	1,039
Telefônica Brasil, S.A.	111	–	–	–	–	–	111
Other companies	416	69	178	29	55	62	809
Total	**7,426**	**857**	**578**	**596**	**123**	**159**	**9,739**

2014

Millions of euros

Company	2015	2016	2017	2018	2019	2020 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	276	638	–	400	–	–	1,314
Telefónica Móviles México, S.A. de C.V.	226	654	–	–	–	–	880
Telefónica de Contenidos, S.A.U.	419	–	–	–	–	–	419
Telefónica de España, S.A.U.	471	–	165	–	550	–	1,186
Telefónica Global Technology, S.A.U.	4	–	–	–	21	177	202
Telefónica Emisiones, S.A.U.	138	–	–	–	–	–	138
Telefónica Digital Holding, S.A.U.	–	155	–	–	–	–	155
Telefónica Internacional, S.A.U.	3,272	–	–	–	–	–	3,272
Other companies	225	106	29	203	36	93	692
Total	**5,031**	**1,553**	**194**	**603**	**607**	**270**	**8,258**

The main loans granted to Group and associated companies are described below:

- The financing extended to Telefónica Móviles España, S.A.U. in 2015 and 2014 consists of two loans for 638 million euros and 400 million euros, with maturity date in 2016 and 2018, respectively, and formalised in 2013 to enable this company to meet its payment obligations. These credits have 4 million euros of accrued interest receivable.

  Moreover, 68 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (272 million euros in 2014).

  At December 31, 2015, the account receivable with Telefónica Móviles México, S.A. de C.V. amounts to 11,697 million Mexican pesos, equivalent to 623 million euros (11,697 million Mexican pesos, equivalent to 654 million euros in 2014). This consideration is recognised as non-current pursuant to the expected collection date at the reporting date. At December 31, 2015, accrued interest receivable totals 255 million euros (226 million euros in 2014), which forms part of the current balance receivable.

- At December 31, 2015, the account receivable with Telefónica de Contenidos, S.A.U. is broken down as follows:

  a) A 340 million-euro participating loan awarded in 2013 and maturity date in May 2015 that has been extended until May 2016 with the same principal amount and conditions, all of which has been drawn down. Interest on this loan is calculated according to the performance of Telefónica de Contenidos, S.A.U. At December 31, 2015 and 2014, no accrued interest is outstanding.

  b) A 79 million-euro participating loan extended in 2005 and maturing in 2015, which has also been extended until May 2016 with the same principal amount and conditions, all of which has been drawn down.

- The 2015 balance for Telefónica de España, S.A.U. consists of a 550 million euros credit facility granted and drawn down in full in November 2014 and maturing in 2019, and a credit facility of 165 million euros maturing in 2017. Additionally, there is also a balance of 370 million euros comprising tax receivables from the subsidiary for its tax expense declared in the consolidated tax return (470 million euros in 2014) and accrued interest of 1 million euros.

- At December 31, 2015, the account receivable from Telefónica Global Technology, S.A.U. consists of a number of long-term financing agreements under participating loans which bear interest based on the business performance of the company, with an outstanding balance at December 31, 2015 of 182 million euros (202 million euros in 2014). There are 18 million euros of interest accrued and not paid included in the chart.

- During January and February 2014, according to their maturity schedule, Telefónica Emisiones S.A.U. bonds totaling 153 million euros and 57 million pounds sterling (equivalent to 69 million euros) were cancelled. The remaining bonds (136 million euros), were booked as short term financial assets according to their maturity schedule have been fully cancelled in the first half of 2015.

- On December, 30, 2015, General Shareholders' Meeting of Telfin Ireland, Ltd. approved a dividend distribution totaling 455 million euros. Out of this amount, 275 million euros correspond to an unrestricted reserve distribution and 180 million are an interim dividend distribution. Both amounts are registered as short term financial receivables at the closing date of these annual accounts.

- In 2015 the General Shareholders' Meeting of Telefónica Internacional, S.A.U. approved the distribution of 1,000 million euros against unrestricted reserves. The amount has been registered as short term financial receivables. In 2015 Telefónica Internacional, S.A.U. has partially cancelled the outstanding amount of dividends from 2014 by the assignment of a loan granted to Telefónica Latinoamérica Holding, S.L.amounting to 709 million euros (706 million as principal and 3 million of accrued interest). At the date of these annual accounts this financial account receivable has not been cancelled.

In 2014 the General Shareholders' Meeting of Telefónica Internacional, S.A.U. approved the distribution of 3,238 million euros against unrestricted reserves. The amount was registered as short term financial receivables.

Moreover, 103 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (34 million euros in 2014).

- In addition to the assignment of the loan granted to Telefónica Latinoamérica Holding, S.L. by Telefónica Internacional, S.A.U. detailed in the previous paragraphs, in December 2015 the Company has approved a dividend distribution charged against unrestricted reserves of 341 million euros. This amount has been partially offset by tax balances due to the subsidiary, and therefore the outstanding balance at year-end is 1,039 million euros.

The Company has also extended 597 million euros (825 million euros in 2014) of loans in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17). The most significant amounts have already been disclosed through this Note. All these amounts fall due in the short term.

Disposals of current loans to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A.'s tax group totaling 825 million euros (355 million euros in 2014).

Total accrued interest receivable at December 31, 2015 included under "Current loans to group companies and associates" amounted to 271 million euros (234 million euros in 2014).

8.6. Other financial assets with Group companies and associates

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees maturing in 2016, 2017 and 2018 (see Note 19.3).

Note 9. Financial investments

9.1. The breakdown of “Financial investments” at December 31, 2015 and 2014 is as follows:

2015

Millions of euros	Assets at fair value				Measurement hierarchy			Assets at amortized cost					
	Available-for-sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on observable market data	Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value	Total carrying amount	Total fair value
Non-current financial investments	**384**	**2,339**	**2,299**	**5,022**	**384**	**4,638**	**–**	**41**	**10**	**51**	**51**	**5,073**	**5,073**
Equity instruments	384	–	–	384	384	–	–	–	–	–	–	384	384
Derivatives (Note 16)	–	2,339	2,299	4,638	–	4,638	–	–	–	–	–	4,638	4,638
Loans to third parties and other financial assets	–	–	–	–	–	–	–	41	10	51	51	51	51
Current financial investments	**–**	**590**	**1,406**	**1,996**	**–**	**1,996**	**–**	**60**	**4**	**64**	**64**	**2,060**	**2,060**
Loans to third parties	–	–	–	–	–	–	–	60	4	64	64	64	64
Derivatives (Note 16)	–	590	1,406	1,996	–	1,996	–	–	–	–	–	1,996	1,996
Total financial investments	**384**	**2,929**	**3,705**	**7,018**	**384**	**6,634**	**–**	**101**	**14**	**115**	**115**	**7,133**	**7,133**

2014

Millions of euros													
	Assets at fair value							Assets at amortized cost					
					Measurement hierarchy								
	Available-for-sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on observable market data	Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value	Total carrying amount	Total fair value
Non-current financial investments	**483**	**2,457**	**2,541**	**5,481**	**483**	**4,998**	**–**	**217**	**11**	**228**	**236**	**5,709**	**5,717**
Equity instruments	483	–	–	483	483	–	–	–	–	–	–	483	483
Derivatives (Note 16)	–	2,457	2,541	4,998	–	4,998	–	–	–	–	–	4,998	4,998
Loans to third parties and other financial assets	–	–	–	–	–	–	–	217	11	228	236	228	236
Current financial investments	**–**	**250**	**238**	**488**	**–**	**488**	**–**	**1,399**	**54**	**1,453**	**1,447**	**1,941**	**1,935**
Loans to third parties	–	–	–	–	–	–	–	1,399	54	1,453	1,447	1,453	1,447
Derivatives (Note 16)	–	250	238	488	–	488	–	–	–	–	–	488	488
Total financial investments	**483**	**2,707**	**2,779**	**5,969**	**483**	**5,486**	**–**	**1,616**	**65**	**1,681**	**1,683**	**7,650**	**7,652**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

9.2 Held-for-trading financial assets and hedges

These two categories include the fair value of outstanding derivate financial instruments at December 31, 2015 and 2014 (see Note 16).

9.3 Available-for-sale financial assets.

This category mainly includes the fair value of investments in listed companies (equity instruments) over which the Company does not have significant control or influence. The movement of items composing this category at December 31, 2015 and 2014 are as follows:

December 31, 2015

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	347	–	–	(10)	(39)	298
Telefónica Czech Republic, a.s.	–	–	–	–	–	–
Telco, S.p.A.	73	–	(603)	15	515	–
Other companies	63	32	–	–	(9)	86
Total	**483**	**32**	**(603)**	**5**	**467**	**384**

December 31, 2014

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	382	–	–	(14)	(21)	347
Telefónica Czech Republic, a.s.	166	–	(160)	–	(6)	–
Telco, S.p.A.	–	–	(270)	358	(15)	73
Other companies	43	37	–	–	(17)	63
Total	**591**	**37**	**(430)**	**344**	**(59)**	**483**

As a result of the loss of significant influence in its indirect investment in Telecom Italia, S.p.A., as reported at the beginning of Note 8, in December 2014 the net carrying amount of the investment in Telco, S.p.A. was registered under this caption, having been previously recognized as associated company. At this same moment, the Company reviewed the value of this investment, booking it at the quoted price of Telecom Italia's shares (0.89 euro per share) minus Telco's debt. As a result of the valuation, 270 million euros of Financial Expense, third parties were registered (See Note 19.9).

The revaluation in the quotation of Telecom Italia, S.p.A.´s shares since January 2015 until the spin off date is shown under "Fair Value adjustments" column of the charts above. In June 2015, the spin off deed of Telco, S.p.A. was filed to the Companies Register. After this spin off, the net book value of the assets and liabilities of the company that according to the percentage of ownership corresponded pro-rata to Telefónica, S.A., were transferred to a newly incorporated subsidiary,Telco TE, S.p.A. as indicated in Note 8. This transaction is registered as "Disposal" in 2015 chart of movements and has originated a financial revenue of 500 million euros (see Note 19).

The impacts shown in the column "Fair value adjustments" on both years include the fair value adjustment, net of tax effect of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). These impacts are registered in the Equity of the Company (Note 11.2.). The effect, recorded both in 2015 and 2014 under "other movements", relates to the sale of rights to scrip dividends that the bank distributed in both years.

At December 31, 2015 Telefónica, S.A.'s investment in BBVA represents 0.69% of that company's share capital.

The investment in Telefónica Czech Republic, a.s. was sold in October 2014 for an amount of 160 million euros. The result of the transaction has been recognised as financial result of the Company.

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2015 and 2014 is as follows:

Millions of euros	2015	2014
Other non-current financial assets:		
Loans to third parties	41	217
Guarantees given	10	11
Other non-current financial assets	–	0
Other current financial assets:		
Loans to third parties	60	1,399
Other current financial assets	4	54
Total	**115**	**1,681**

9.4.1 Loans to third parties

The full amount within non-current loans in 2014 was the deferred account receivable generated from the sale of Telefónica Czech Republic, a.s. completed on January 28, 2014. This same item amounted to 86 million euros as current loans. In November 2015, the Company agreed with PPF Group, N.V.I. an early prepayment of the total outstanding amount.

On February 27, 2015 Telco, S.p.A. reimbursed the total amounts of bank liabilities and bonds with the proceeds from its shareholders (2,555 million euros of which 1,687 million corresponded pro-rata to Telefónica, S.A.). After the spin off process of Telco, S.p.A. previously mentioned, the liability of the shareholders' loan was transferred to Telco TE, S.p.A. In June 2015, this loan was completely cancelled. In 2014, the same concept was shown as loans to third parties.

In June 2015, when the sale of the shares of Telecom Italia, S.p.A. was completed (see Note 8), Telefónica arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia, S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia S.p.A. (see Note 13). This "Equity Swap" contract envisages a premium for Telefónica, S.A. that it is being quaterly cashed until the contract vesting in 2017. The pending amounts are registered in the balance sheet according to its maturity schedule. As of December 31, 2015 there are 41 million euros as long term loans to third parties and 55 million euros as short term loans to third parties.

Note 10. Trade and other receivables

The breakdown of “Trade and other receivables” at December 31, 2015 and 2014 is as follows:

Millions of euros	2015	2014
Trade receivables	10	2
Trade receivables from Group companies and associates	295	422
Other receivables	1	1
Employee benefits receivable	2	2
Tax receivables (Note 17)	286	654
Total	**594**	**1,081**

“Trade receivables from Group companies and associates” mainly includes amounts receivable from subsidiaries for the impact of the rights to use the Telefónica brand and the monthly office rental fees (see Note 7).

“Trade receivables” and “Trade receivables from Group companies and associates” in 2015 and 2014 include balances in foreign currency equivalent to 150 million and 267 million euros, respectively. In both years these amounts relate entirely to receivables in US dollars.

These balances gave rise to exchange gains in the income statement of approximately 22 million euros in 2015 (2 million euros of exchange gains in 2014).

Note 11. Equity

11.1 Capital and reserves

a) Share capital

2015

On April 20, 2015, the public deed evidencing the share capital increase granted by Telefónica, S.A. was registered with the Commercial Registry of Madrid for a nominal value of 281,213,184 million euros recorded as "share capital". The difference with the effective amount issued, amounting 3,048,350,914.56 million euros was recorded as Share premium.

On July 24, 2015, the public deed of the share capital reduction was registered, cancelling 74,076,263 of the own shares, reducing the company's share capital by 74,076,263 euros.

On December 10, 2015, the need of a share capital increase of 110,857,946 euros was executed, during which 110,857,946 ordinary share with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,975,199,197 euros subsequence to this increase.

At December 31, 2015, Telefónica, S.A.'s share capital amounted to 4,975,199,197 euros and consisted of 4,975,199,197 fully paid ordinary shares of a single series, par value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system ("Continuous Market"), where they form part of the "Ibex 35" Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through American Depositary Shares ('ADSs').

2014

On December 9, 2014, the deed of a share capital increase of 106,179,744 euros was executed, during which 106,179,744 ordinary shares with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,657,204,330 euros subsequent to this increase.

Authorizations by Shareholders' Meeting

With respect to authorizations given regarding share capital, on June 12, 2015, authorization was given at the Annual Shareholders' Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, once or several times, within a maximum period of five years from that date, up to a maximum nominal increase of 2,469,208,757 euros, equivalent to half of Telefónica, S.A.'s share capital at that date, by issuing and placing new shares, -with or without a share premium, and, in all cases, in exchange for cash, expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Section 506 of the Spanish Enterprises Act. However, the power to exclude preemptive rights is limited to 20% of the Company's share capital on the date of adoption of this resolution.

Furthermore, on May 30, 2014, shareholders voted to authorize the acquisition by the Board of Directors of Telefónica, S.A. treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders' Meeting, within a maximum period of five years from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

In addition, at the May 30, 2014 Shareholders' Meeting, authorization was given for the Board of Directors to issue debentures, bonds, notes and other fixed-income securities and hybrid instruments, including preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, or debt instruments of similar category or hybrid instruments whatever may be the forms admitted in law, plain or, in the case of debentures, bonds and hybrid instruments convertible into shares of the Company and/or exchangeable for shares of any of the Group companies, or any other company. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares of the Company, whether newly issued or outstanding, and which may be paid for by physical delivery or by offset. The aggregated amount of the issuance(s) of securities approved under this delegation of powers may not exceed, at any given time, the sum of 25,000 million or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under the authorization will be calculated for purposes of the aforementioned limit. Also for purposes of the foregoing limit, in the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance that is approved under the delegation shall be taken into account.

At December 31, 2015 and 2014, Telefónica, S.A. held the following treasury shares:

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/31/15	141,639,159	11.69	10.24	1,450	2.84690%

(1)Millions of euros

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/31/14	128,227,971	11.68	11.92	1,528	2.75332%

(1)Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2015 and 2014 is as follows:

	Number of shares
Treasury shares at 12/31/13	**29,411,832**
Acquisitions	100,723,415
Disposals	(129,177)
GESP share plan delivery	(1,778,099)
Treasury shares at 12/31/14	**128,227,971**
Acquisitions	138,036,450
Disposals	(47,824,300)
Share redemption	(74,076,263)
PIP II share plan delivery (Note 19.3)	(2,724,699)
Treasury shares at 12/31/15	**141,639,159**

Acquisitions

The amount of the acquisitions of treasury shares in 2015 and 2014 was 1,654 million euros and 1,176 million euros, respectively.

Share redemption and disposals

On July 24, 2015, pursuant to the resolution of the share capital reduction, by the cancellation of own shares, adopted by the Annual General Shareholders' Meeting of Telefónica held on June 12, 2015, and following the execution agreement adopted by the Board of Directors of the Company, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (Registro Mercantil). Therefore, 74,076,263 of the own shares of Telefónica, S.A. totalling 886 million euros have been cancelled, reducing the company's share capital by 74 million euros.

Treasury shares sold in 2015 and 2014 amounted to 593 million euros and 1 million euros, respectively. The main treasury share sale transaction was on July 29, 2015 when Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica has committed to deliver 46.0 million of its treasury shares, in exchange for 58.4 million preferred shares of Telefônica Brasil, S.A. (received by Vivendi, S.A. in the context of the acquisition of GVT Participaçoes, S.A.), representing 3.5% of the share capital of Telefônica Brasil, S.A. (See Note 8). The impact in equity amounts to 555 million euros.

On June 30, 2015, the second phase of the Telefónica, S.A. long-term incentive plan called “Performance and Investment Plan 2012-2015” (“PIP 2012-2015”) ended. According to the level of “Total Shareholder Return” (TSR) achieved, 77%, 2,724,699 shares were delivered. In addition to these disposals, on November 28, 2014, 1,778,099 shares were delivered to Group employees when the second phase of the Global Employee Share Plan (“the GESP”) matured.

Options on treasury shares

At December 31, 2015, all the contracts of call option on treasury shares subject to physical delivery at a fixed price have reached the maturity date or have been executed (76 million options on treasury shares at December 31, 2014), which were presented as a reduction in equity under the caption “Treasury shares”. These contracts were valued, in previous periods, at the amount of premium paid, and upon maturity if the call options were exercised the premium was reclassified as treasury shares together with the price paid. If they were not exercised upon maturity their value was recognized directly in equity.

The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 33,8 million of Telefónica shares in 2015 (32 million shares in 2014), recognized in both years under “Current interest-bearing debt” in the accompanying balance sheet.

b) Legal reserve

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2014, the Company had duly set aside this reserve. After the capital increase carried forward in 2015, the Company needs to increase the legal reserve by 11 million euros. The proposed appropriation of profit (see Note 3) includes an allocation of the 10% of 2015 net profit (1 million euros) regarding this concept.

c) Other reserves

“Other reserves” includes:

- The “Revaluation reserve” which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2015 and 2014, an amount of 8 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to “Other reserves” in both periods. The balance of this reserve at December 31, 2015 and 2014 was 93 million euros and 101 million euros, respectively.

- Reserve for cancelled share capital: In accordance with Section 335.c) of the Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. In 2015 a new reserve for cancelled capital share amounting to 74 million euros has been created. The cumulative amount of the reserve for cancelled share capital at December 31, 2015 and 2014 was 656 and 582 million euros, respectively.

- Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company sets aside a non-distributable reserve of 2 million euros for goodwill amortization. The balance of this reserve at December 31, 2015 was 12 million euros. The proposed appropriation of 2015 profit (see Note 3) includes an allocation of 2 million euros to this restricted reserve.

- In addition to the restricted reserves explained above, "Other reserves" includes unrestricted reserves from gains obtained by the Company in prior years.

d) Dividends

Dividends paid in 2015

Approval was given at the Board of Directors' Meeting of April 29, 2015 to pay a gross 0.4 euros dividend per outstanding share against 2015 profit. This dividend was paid on May 12, 2015 and the total gross amount paid was 1,912 million euros.

At its meeting held on November 13, 2015, the Executive Commission of Telefonica, S.A.'s Board of Directors agreed to carry out the execution of the increase in paid-up capital, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder´s Meeting held on June 12, 2015.

Thus, each shareholder received one free allotment right for each Telefónica share held. Such free allotment rights were traded on the Continuous Market in Spain during a period of fifteen calendar days. Once this trading period ended, the shareholders of 20.01% of the free-of-charge allotment rights accepted the irrevocable purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was made on December 7, 2015, representing an impact in equity of 337 million euros.

The shareholders of 79.99% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares corresponding to its treasury shares, so the final number of shares issued in the capital increase was 110,857,946 shares with a nominal value of 1 euro each.

Dividends paid in 2014

The Board of Directors' at its meeting of April 25th, 2014 approved the payment of an interim dividend of 0.4 euros per share outstanding. The dividend was paid on May 7th, 2014 and the total amount paid was 1,790 million euros.

The Executive Commission of Telefonica, S.A. Board of Directors, at its meeting held on November 14, 2014, agreed to carry out the execution of the free-of-charge capital increase, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder´s Meeting held on May 30, 2014.

After this approval, each shareholder received one free allotment right for each Telefónica Share held. Such free allotment rights were traded on the continuous Market in Spain during a period of fifteen calendar days.

Once this trading period ended, the shareholders of 15.8% of the free-of-charge allotment rights have accepted the purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was carried into effect on December 8, 2014, assuming an impact on equity of 242 million euros.

The shareholders of 84.2% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares that correspond to the treasury shares, so the final number of shares issued in the capital increase was 106,179,744 shares with a nominal value of 1 euro each.

e) Other equity instruments

On September 24, 2014, Telefónica Participaciones, S.A.U., issued 1,500 million euros of bonds necessarily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. The notes could be converted at the option of the noteholders or the issuer at any time from the 41st day after the Issue Date up to the 25th trading day prior to the Maturity Date. The minimum conversion price of the notes will be equal to 11.9 euros per share and the maximum conversion price will be equal to 14.5775 euros per share, resulting in a premium equal to 22.5% over the minimum conversion price.

On the same date, Telefónica, S.A. issued bonds with the same amount and characteristics of the previously detailed bond and a derivative instrument (warrant) in order to hedge the conversion price of the bonds. These bonds were wholly acquired by Telefónica Participaciones, S.A.U. In the balance sheet of Telefónica, S.A. the present value of the coupons was recorded as debt (See Note 15), the warrant was accounted as long term liabilities to group companies (see Note 16) and the remaining amount of 1,206 million euros has been recorded as "other net equity instruments".

11.2 Unrealized gains (losses) reserve

The movements in the items composing “Unrealized gains (losses) reserve” in 2015 and 2014 are as follows:

2015

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	20	467	(130)	(481)	135	11
Cash flow hedges (Note 16)	(1,084)	380	(137)	56	(16)	(801)
Total	**(1,064)**	**847**	**(267)**	**(425)**	**119**	**(790)**

2014

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	49	(59)	17	19	(6)	20
Cash flow hedges (Note 16)	(880)	(411)	93	163	(49)	(1,084)
Total	**(831)**	**(470)**	**110**	**182**	**(55)**	**(1,064)**

Note 12. Financial liabilities

The breakdown of "Financial liabilities" at December 31, 2015 and 2014 is as follows:

2015

	LIABILITIES AT FAIR VALUE						LIABILITIES AT AMORTIZED COST			
				MEASUREMENT HIERARCHY						
Millions of euros	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data	Trade and other payables	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
Non-current financial liabilities	**2,361**	**486**	**2,847**	**–**	**2,847**	**–**	**42,446**	**44,868**	**45,293**	**47,715**
Payable to Group companies and associates	–	–	–	–	–	–	36,683	39,109	36,683	39,109
Bank borrowings	–	–	–	–	–	–	4,825	4,805	4,825	4,805
Bonds and other marketable debt securities	–	–	–	–	–	–	800	816	800	816
Derivatives (Note 16)	2,361	486	2,847	–	2,847	–	–	–	2,847	2,847
Other financial liabilities	–	–	–	–	–	–	138	138	138	138
Current financial liabilities	**236**	**38**	**274**	**–**	**274**	**–**	**14,571**	**13,853**	**14,845**	**14,127**
Payable to Group companies and associates	–	–	–	–	–	–	13,217	12,502	13,217	12,502
Bank borrowings	–	–	–	–	–	–	1,269	1,265	1,269	1,265
Bonds and other marketable debt securities	–	–	–	–	–	–	85	86	85	86
Derivatives (Note 16)	236	38	274	–	274	–	–	–	274	274
Total financial liabilities	**2,597**	**524**	**3,121**	**–**	**3,121**	**–**	**57,017**	**58,721**	**60,138**	**61,842**

2014

Millions of euros	LIABILITIES AT FAIR VALUE: Financial liabilities held for trading	LIABILITIES AT FAIR VALUE: Hedges	LIABILITIES AT FAIR VALUE: Subtotal financial liabilities at fair value	MEASUREMENT HIERARCHY: Level 1: quoted prices	MEASUREMENT HIERARCHY: Level 2: Estimates based on other directly observable market inputs	MEASUREMENT HIERARCHY: Level 3: Estimates not based on other directly observable market data	LIABILITIES AT AMORTIZED COST: Trade and other payables	LIABILITIES AT AMORTIZED COST: Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
Non-current financial liabilities	**2,322**	**800**	**3,122**	**–**	**3,122**	**–**	**45,675**	**50,313**	**48,797**	**53,435**
Payable to Group companies and associates	–	–	–	–	–	–	40,728	45,287	40,728	45,287
Bank borrowings	–	–	–	–	–	–	4,027	4,070	4,027	4,070
Bonds and other marketable debt securities	–	–	–	–	–	–	831	867	831	867
Derivatives (Note 16)	2,322	800	3,122	–	3,122	–	–	–	3,122	3,122
Other financial liabilities	–	–	–	–	–	–	89	89	89	89
Current financial liabilities	**264**	**101**	**365**	**–**	**365**	**–**	**12,538**	**11,930**	**12,903**	**12,295**
Payable to Group companies and associates	–	–	–	–	–	–	11,702	11,107	11,702	11,107
Bank borrowings	–	–	–	–	–	–	759	760	759	760
Bonds and other marketable debt securities	–	–	–	–	–	–	77	63	77	63
Derivatives (Note 16)	264	101	365	–	365	–	–	–	365	365
Other financial liabilities	–	–	–	–	–	–	–	–	–	–
Total financial liabilities	**2,586**	**901**	**3,487**	**–**	**3,487**	**–**	**58,213**	**62,243**	**61,700**	**65,730**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

Note 13. Bonds and other marketable debt securities

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2015 and 2014 are as follows:

2015

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	**902**	**6**	**908**
Additions	–	83	83
Depreciation and amortization	(50)	(24)	(74)
Revaluation and other movements	(32)	–	(32)
Closing balance	**820**	**65**	**885**
Details of maturities:			
Non-current	800	–	800
Current	20	65	85

2014

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	**761**	**359**	**1,120**
Additions	750	6	756
Depreciation and amortization	(613)	(361)	(974)
Revaluation and other movements	4	2	6
Closing balance	**902**	**6**	**908**
Details of maturities:			
Non-current	831	–	831
Current	71	6	77

In March 2015, in accordance with its maturity schedule, the Company cancelled the bonds issued in 2000. This movement is included as “Disposals” in the column of Non-convertible debentures and bonds of the 2015 chart of movements.

The additions shown in the table of movements for 2014 in the column “Non-convertible debentures and bonds” referred to Telefónica’s bond issuance made on July 24, 2014 amounting to 750 million euros. The bonds were mandatorily exchangeable into ordinary shares of Telecom Italia, S.p.A, maturing on July 24, 2017. The bonds might be exchanged in advance of the transfer of the shares, except under certain circumstances where the company might opt to redeem the bonds in cash.

Maturities of the nominal amounts of debenture and bond issues at December 31, 2015 and 2014 are as follows:

2015

Millions of euros			Maturity						
Name	Interest rate	% interest rate	2016	2017	2018	2019	2020	Subsequent years	TOTAL
DEBENTURES AND BONDS:									
Bonds exchangeable into Telecom Italia shares	FIXED	6.00%	–	750	–	–	–	–	750
Total issues			**–**	**750**	**–**	**–**	**–**	**–**	**750**

2014

Millions of euros			Maturity						
Name	Interest rate	% interest rate	2015	2016	2017	2018	2019	Subsequent years	TOTAL
DEBENTURES AND BONDS:									
MARCH 00	FLOATING	2.80%(*)	50	–	–	–	–	–	50
Bonds exchangeable into Telecom Italia shares	FIXED	6.00%	–	–	750	–	–	–	750
Total issues			**50**	**–**	**750**	**–**	**–**	**–**	**800**

(*) The applicable interest rate (floating, set annually) is the sterling 10-year swap rate multiplied by 1.0225.

13.2 At December 31, 2015, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

Millions of euros Amount	Placement system	Nominal amount of the Promissory notes	Terms of the Promissory notes	Placement
500 million; can be increased to 2,000 million	Auctions	100,000 euros	30, 60, 90, 180, 365, 540 and 731 days	Competitive auctions
	Tailored	100,000 euros	Between 3 and 731 days	Specific transactions

At December 31, 2015 the outstanding balance on this promissory note program was 65 million euros (6 million euros in 2014).

13.3 The average interest rate during 2015 on debentures and bonds outstanding during the year was 5.96% (5.15% in 2014) and the average interest rate on corporate promissory notes was 0.14% (0.43% in 2014).

Note 14. Interest-bearing debt and derivates

14.1 The balances at December 31, 2015 and 2014 are as follows:

December 31, 2015

Millions of euros			
Item	Current	Non-current	Total
Loans with financial entities	1,269	4,825	6,094
Derivative financial liabilities (Note 16)	274	2,847	3,121
Total	**1,543**	**7,672**	**9,215**

December 31, 2014

Millions of euros			
Item	Current	Non-current	Total
Loans with financial entities	759	4,027	4,786
Derivative financial liabilities (Note 16)	365	3,122	3,487
Total	**1,124**	**7,149**	**8,273**

14.2 The nominal values of the main interest-bearing debts at December 31, 2015 and 2014 are as follows:

Description	Value Date	Marturity Date	Currency	Limit 12/31/15 (millions)	Balance (million of euros)
Structured financing*	05/03/11	07/30/21	USD	247	226
Structured financing *	02/22/13	01/31/23	USD	786	722
Structured financing *	08/01/13	10/31/23	USD	618	447
Syndicated facility	02/18/14	02/18/19(1)	EUR	3,000	700
Bilateral *	06/26/14	06/26/18(2)	EUR	1,500	1,500
Syndicated facility	02/19/15	02/19/20(3)	EUR	2,500	500
Bilateral	06/30/15	06/30/20	EUR	200	200
Syndicated facility	11/17/15	02/17/18	EUR	3,000	-
Structured financing *	12/11/15	03/11/26	USD	750	-
Structured financing *	12/11/15	03/11/26	EUR	500	-

* Facilities with amortization schedule.
(1) The parties could mutually agree to extend the maturity to as late as 2021.
(2) On 06/25/15 an amendment was signed modifying the maturity date and including an amortization schedule. On 07/01/15 an early repayment for 500 million euros was made.
(3) The parties could mutually agree to extend the maturity to as late as 2022.

Description	Value Date	Marturity Date	Currency	Limit 12/31/14 (millions)	Balance (million of euros)
Syndicated loan (1) *	04/21/06	04/21/17	EUR	700	700
Syndicated loan Tranche A3	07/28/10	07/28/16	EUR	328	328
Structured financing*	02/22/13	01/31/23	USD	905	571
Bilateral	06/26/14	06/26/17	EUR	2,000	2,000

* Facilities with amortization schedule.
(1) 350 million euros are scheduled to mature on 04/21/15

14.3 Maturities of balances at December 31, 2015 and 2014 are as follows:

December 31, 2015

Millions of euros Items	2016	2017	2018	2019	2020	Subsequent years	Closing balance
	Maturity						
Loans with financial entities	1,269	174	1,596	1,065	872	1,118	6,094
Derivative financial liabilities (Note 16)	274	658	330	256	799	804	3,121
Total	**1,543**	**832**	**1,926**	**1,321**	**1,671**	**1,922**	**9,215**

December 31, 2014

Millions of euros Items	2015	2016	2017	2018	2019	Subsequent years	Closing balance
	Maturity						
Loans with financial entities	759	508	2,531	232	427	329	4,786
Derivative financial liabilities (Note 16)	365	147	345	476	357	1,797	3,487
Total	**1,124**	**655**	**2,876**	**708**	**784**	**2,126**	**8,273**

14.4 Interest-bearing debt arranged or repaid in 2015 mainly includes the following:

- On February 19, 2015, Telefónica, S.A. signed a 2,500 million euros syndicated credit facility maturing in 2020, even though by mutual agreement between the parties could be extended to a maximum maturity in 2022. At December 31, 2015, the outstanding balance under this financing was 500 million euros. This agreement entered into effect on February 26, 2015 and allowed us to cancel in advance the syndicated loan facility of Telefónica Europe, B.V. (Telefónica, S.A.'s subsidiary) dated on March 2, 2012 with two tranches of 756 million euros and 1,469 million pounds sterling originally scheduled to mature in 2017. On the same date, Telefónica, S.A. signed an amendment to its 3,000 million euros syndicated credit facility arranged on February 18, 2014 maturing in 2019 in which was included an option by mutual agreement between the parties to extend the maturity up to 2021. At December 31, 2015, the outstanding balance under this financing was 700 million euros.

- On June 25, 2015, Telefónica, S.A. signed an amendment to its 2,000 million euros bilateral loan arranged on June 26, 2014 modifying the maturity date to June 26, 2018 and including an amortization schedule. On July 1, 2015 an early repayment for 500 million euros was made of which original maturity was in 2017.

- On June 30, 2015, Telefónica, S.A. entered into a long-term credit facility for an aggregate amount of 200 million euros which matures in 2020. At December 31, 2015, the outstanding balance under this facility was 200 million euros.

- On November 17, 2015, Telefónica, S.A. signed a 3,000 million euros syndicated revolving facility maturing in 2018. As of December 31, 2015, there was no outstanding amount under this credit.

- On December 11, 2015, Telefónica, S.A. entered into a long-term credit facility for an aggregate amount of 750 million US dollars (approximately 689 million euros) at a fixed rate with the guarantee of the Swedish Export Credits Guarantee Board (EKN) which matures in 2026. At December 31, 2015, there was no outstanding amount under this facility.

- On December 11, 2015, Telefónica, S.A. entered into a long-term credit facility for an aggregate amount of 500 million euros at a fixed rate with the guarantee of the Finnish Export Credits Guarantee Board (Finnvera) which matures in 2026. At December 31, 2015, there was no outstanding amount under this facility.

- During 2015, Telefónica, S.A. made an early repayment for 328 million euros of its syndicated loan (tranche A3) dated July 28, 2010 and scheduled to mature originally on July 28, 2016. As of December 31, 2015 there was no outstanding balance under this facility.

- During 2015, Telefónica, S.A. repaid in full its syndicated loan dated April 21, 2006 (for a total amount of 700 million euros), of which 350 million euros were scheduled to mature originally in 2017.

- During 2015, Telefónica, S.A. drew down 198 million dollars (equivalent to 182 million euros) and repaid 105 million dollars (equivalent to 96 million euros) of its 1,001 million dollars long-term credit facility arranged on February 22, 2013 and maturing in 2023. At December 31, 2015 the outstanding amount of this facility was 786 million dollars (equivalent to 722 million euros).
- During 2015, Telefónica, S.A. drew down 353 million dollars (equivalent to 324 million euros) and repaid 59 million dollars (equivalent to 54 million euros) of its 734 million dollars long-term credit facility arranged on August 1, 2013 and maturing in 2023. At December 31, 2015 the outstanding amount of this facility was 487 million dollars (equivalent to 447 million euros).

14.5 Average interest on loans and borrowings

The average interest rate in 2015 on loans and borrowings denominated in euros was 0.557% and 2.099% for foreign-currency loans and receivables.

The average interest rate in 2014 on loans and borrowings denominated in euros was 1.048% and 2.250% for foreign-currency loans and receivables.

14.6 Unused credit facilities

The balances of loans and borrowings relate only to amounts drawn down.

At December 31, 2015 and 2014, Telefónica had undrawn credit facilities amounting to 11,705 million euros and 7,445 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2015 and 2014 is not subject to compliance with financial ratios (covenants).

Note 15. Payable to group companies and associates

15.1 The breakdown at December 31, 2015 and 2014 is as follows:

December 31, 2015

Millions of euros	Non-current	Current	Total
Loans	36,517	12,221	48,738
Trade payables to Group companies and associates	7	805	812
Derivatives (Note 16)	131	22	153
Payable to subsidiaries due to taxation on a consolidated basis	28	169	197
Total	**36,683**	**13,217**	**49,900**

December 31, 2014

Millions of euros	Non-current	Current	Total
Loans	40,415	11,265	51,680
Trade payables to Group companies and associates	21	152	173
Derivatives (Note 16)	107	12	119
Payable to subsidiaries due to taxation on a consolidated basis	185	273	458
Total	**40,728**	**11,702**	**52,430**

The maturity of these loans at the 2015 and 2014 year ends is as follows:

December 31, 2015

Company (Millions of euros)	2016	2017	2018	2019	2020	2020 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	7,369	5,283	3,998	3,443	3,704	13,140	36,937
Telefónica Europe, B.V.	1,683	–	1,119	850	1,558	3,350	8,560
Telfisa Global, B.V.	2,571	–	–	–	–	–	2,571
Telefónica Finanzas, S.A.U.	500	–	–	–	–	–	500
Others	98	72	–	–	–	–	170
Total	**12,221**	**5,355**	**5,117**	**4,293**	**5,262**	**16,490**	**48,738**

December 31, 2014

Company (Millions of euros)	2015	2016	2017	2018	2019	2019 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	3,962	6,391	4,774	3,786	3,347	14,897	37,157
Telefónica Europe, B.V.	1,451	–	–	1,104	847	5,035	8,437
Telfisa Global, B.V.	3,913	–	–	–	–	–	3,913
Telefónica Finanzas, S.A.U.	1,837	75	–	–	–	–	1,912
Others	102	–	142	–	–	17	261
Total	**11,265**	**6,466**	**4,916**	**4,890**	**4,194**	**19,949**	**51,680**

Financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2015 was 8,560 million euros (8,437 million euros in 2014). This financing entails a number of loans paying market interest rates calculated on a Euribor plus spread basis, with an average interest rate in 2015 of 5.01% (5.00% in 2014). The main source of this financing was the funds obtained through the issuance of undated deeply subordinated reset rate guaranteed securities amounting 5,167 million euros (5,120 million euros in 2014), bonds and debentures amounting 1,648 million euros (1,530 million euros in 2014) and commercial paper amounting 1,431 million euros (496 million euros in 2014).

Financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2015 was 36,937 million euros (37,157 million euros in 2014). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2015 was 4.63% (4.69% in 2014). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2015 mainly by tapping the European and US capital markets, issuing bonds totaling 1,467 million euros (2,962 million euros in 2014). The characteristics of the main bonds issued during 2015 are the following:

Description	Issue date	Maturity date	Amount in millions (nominal)	Currency of issue	Amount in millions of euros (nominal)	Coupon
Telefónica Emisiones, S.A.U.						
EMTN bonds	06/18/15	06/19/17	300	EUR	300	Euribor 3M+0.33%
	09/14/15	09/14/21	1,000	EUR	1,000	1.477%
	12/11/15	12/11/17	100	EUR	100	Euribor 3M+0.53%

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes restatements to amortized cost at December 31, 2015 and 2014 as a result of fair value interest rate and exchange rate hedges.

Meanwhile, at December 31, 2015, Telefónica, S.A. had raised financing from Telefónica Finanzas, S.A.U., in charge of the integrated cash management of the companies comprising the Telefónica Group in Spain, with an outstanding balance of 500 million euros at December 31, 2015 (1,912 million euros at December 31, 2014) in a series of loans bearing interest at market rates.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States and Europe. The balance payable to this subsidiary is formalized through several Deposit Agreements accruing interest at market rates and amounting to 2,571 million euros in 2015 (3,913 million euros in 2014).

Financing raised by Telefónica, S.A. through Telefónica Participaciones, S.A.U. at December 31, 2015 totals 145 million euros (217 million euros in 2014) and it has been shown as “Others” in 2015 and 2014 chart of movements. This financing corresponds to the actual value of the interests from a bond issuance launched on September 24, 2014 by Telefónica, S.A. and fully subscribed by Telefónica Participaciones, S.A.U. with an average interest rate of 4.90% (see Note 11.e). The nominal value of the previously mentioned issuance (1,500 million euros) of bonds necessarily convertible into treasury shares has been booked as “Other equity instruments”.

Loans to Group companies under current assets include accrued interest receivable at December 31, 2015 of 755 million euros (917 million euros in 2014).

15.2 The balance of “Payable to subsidiaries due to taxation on a consolidated basis” was 197 million euros and 458 million euros at December 31, 2015 and 2014, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax losses) to the tax group headed by Telefónica, S.A. (see Note 17). The current- or non-current classification is based on the Company’s projection of maturities.

The main amounts are those relating to Telefónica Internacional, S.A.U. for 84 million euros (97 million euros in 2014), Telefónica Digital España, S.A.U. for 38 million euros (56 million euros in 2014), Telefónica Móviles España, S.A.U. for 8 million euros (101 million euros in 2014), Latin American Cellular Holdings, S.L for 122 million euros in 2014 and no significant amounts in 2015.

Note 16. Derivate financial instruments and risk management policies

a) Derivative financial instruments

During 2015, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2015, the total outstanding balance of derivatives transactions was 144,823 million euros (162,926 million euros in 2014), of which 112,276 million euros related to interest rate risk and 32,547 million euros to foreign currency risk. In 2014, 132,950 million euros related to interest rate risk and 29,276 million euros to foreign currency risk.

It should be noted that at December 31, 2015, Telefónica, S.A. had transactions with financial institutions to hedge exchange rate risk for other Telefónica Group companies amounting to 2,618 million euros (2,420 million euros in 2014). At year-end 2015 and 2014, the Company had no transactions to hedge interest rate risk for other Group companies. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

The breakdown of Telefónica, S.A.'s interest rate and exchange rate derivatives at December 31, 2015, their notional amounts at year end and the expected maturity schedule is as follows:

2015

Millions of euros		Telefonica receives		Telefonica pays	
Type of risk	Value in Euros	Carrying	Currency	Carrying	Currency
Euro interest rate swaps	**79,718**				
Fixed to fixed	65	65	EUR	65	EUR
Fixed to floating	44,199	44,199	EUR	44,199	EUR
Floating to fixed	35,454	35,454	EUR	35,454	EUR
Foreign currency interest rate swaps	**30,273**				
Fixed to floating					
CHFCHF	577	625	CHF	625	CHF
CZKCZK	429	11,600	CZK	11,600	CZK
GBPGBP	5,212	3,825	GBP	3,825	GBP
JPYJPY	130	17,000	JPY	17,000	JPY
USDUSD	19,403	21,124	USD	21,124	USD
Floating to fixed					
CZKCZK	46	1,250	CZK	1,250	CZK
GBPGBP	2,510	1,843	GBP	1,843	GBP
USDUSD	1,966	2,141	USD	2,141	USD
Exchange rate swaps	**16,303**				
Fixed to fixed					
BRLEUR	96	313	BRL	96	EUR
EURBRL	516	516	EUR	2,193	BRL
EURCZK	361	361	EUR	9,759	CZK
Fixed to floating					
JPY/EUR	95	15,000	JPY	95	EUR
Floating to floating					
CHFEUR	515	625	CHF	515	EUR
EURGBP	551	551	EUR	405	GBP
GBPEUR	1,721	1,350	GBP	1,721	EUR
JPYEUR	167	17,000	JPY	167	EUR
USDEUR	12,281	15,858	USD	12,281	EUR
Forwards	**13,428**				
BRLEUR	107	412	BRL	107	EUR
CLPEUR	1	990	CLP	1	EUR
EURBRL	230	230	EUR	977	BRL
EURCLP	49	49	EUR	37,800	CLP
EURGBP	5,697	5,697	EUR	4,181	GBP
EURMXN	1	1	EUR	13	MXN
EURUSD	4,129	4,129	EUR	4,495	USD
GBPEUR	1,554	1,140	GBP	1,554	EUR
USDBRL	16	18	USD	70	BRL
USDCLP	4	4	USD	2,757	CLP
USDCOP	1	1	USD	4,402	COP
USDEUR	1,178	1,273	USD	1,178	EUR
USDGBP	51	58	USD	38	GBP
USDPEN	2	2	USD	7	PEN
CZKEUR	408	11,009	CZK	408	EUR
Spots	**2**				

EURGBP	2	2	EUR	1	GBP
USDGBP	–	1	USD	–	GBP
Subtotal	**139,724**				

Millions of euros

Notional amounts of structured products with options	Value in euros	Notional	Currency
Interest rate options Caps & Floors	**2,285**		
Caps&Floors	**2,285**		
USD	13	14	USD
EUR	1,250	1,250	EUR
GBP	1,022	750	GBP
Currency options	**2,814**		
EURUSD	714	714	EUR
USDEUR	1,558	1,696	USD
EURGBP	542	542	EUR
Subtotal	**5,099**		
TOTAL	**144,823**		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	**261**	**–**	**61**	**200**	**–**
Loans	**33,533**	**3,309**	**9,297**	**8,528**	**12,399**
in national currency	22,035	1,775	5,100	6,900	8,260
in foreign currencies	11,498	1,534	4,197	1,628	4,139
Debentures and bonds MtM	**76,601**	**17,275**	**18,333**	**20,973**	**20,020**
in national currency	30,445	3,045	12,650	12,050	2,700
in foreign currencies	46,156	14,230	5,683	8,923	17,320
Other underlying*	**34,428**	**15,389**	**10,401**	**2,710**	**5,928**
CCS	9,086	9,086	–	–	–
Currency options	2,323	1,853	438	32	–
Forward	2,990	718	2,272	–	–
IRS	20,029	3,732	7,691	2,678	5,928
Total	**144,823**	**35,973**	**38,092**	**32,411**	**38,347**

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.

The breakdown of Telefónica, S.A.'s derivatives in 2014, their notional amounts at year end and the expected maturity schedule is as follows:

2014

Millions of euros		Telefonica receives		Telefonica pays	
Type of risk	Value in Euros	Carrying	Currency	Carrying	Currency
Euro interest rate swaps	**101,258**				
Fixed to fixed	85	85	EUR	85	EUR
Fixed to floating	45,923	45,923	EUR	45,923	EUR
Floating to fixed	55,200	55,200	EUR	55,200	EUR
Floating to floating	50	50	EUR	50	EUR
Foreign currency interest rate swaps	**29,456**				
Fixed to floating					
CHFCHF	520	625	CHF	625	CHF
CZKCZK	418	11,600	CZK	11,600	CZK
GBPGBP	4,866	3,790	GBP	3,790	GBP
JPYJPY	117	17,000	JPY	17,000	JPY
USDUSD	18,674	22,672	USD	22,672	USD
Floating to fixed					
CZKCZK	45	1,250	CZK	1,250	CZK
GBPGBP	2,359	1,838	GBP	1,838	GBP
USDUSD	2,457	2,984	USD	2,984	USD
Exchange rate swaps	**15,191**				
Fixed to fixed					
EURBRL	466	466	EUR	1,502	BRL
EURCLP	51	51	EUR	37,800	CLP
EURCZK	352	352	EUR	9,759	CZK
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to floating					
CHFEUR	515	625	CHF	515	EUR
EURCZK	148	148	EUR	4,114	CZK
EURGBP	519	519	EUR	405	GBP
GBPEUR	829	700	GBP	829	EUR
JPYEUR	167	17,000	JPY	167	EUR
USDEUR	12,049	16,074	USD	12,049	EUR
Forwards	**12,435**				
BRLEUR	2,755	9,312	BRL	2,755	EUR
CLPEUR	14	10,063	CLP	14	EUR
EURBRL	384	384	EUR	5	BRL
EURCZK	24	24	EUR	667	CZK
EURGBP	1,646	1,646	EUR	1,282	GBP
EURMXN	225	225	EUR	4,031	MXN
EURUSD	2,939	2,939	EUR	3,569	USD
GBPEUR	2,176	1,725	GBP	2,176	EUR
GBPUSD	57	44	GBP	69	USD
USDBRL	21	25	USD	66	BRL
USDCLP	5	6	USD	3,752	CLP
USDCOP	1	1	USD	2,976	COP

USDEUR	1,884	2,357	USD	1,884	EUR
USDGBP	36	44	USD	28	GBP
USDPEN	2	2	USD	5	PEN
CZKEUR	266	7,352	CZK	266	EUR
Subtotal	**158,340**				

Millions of euros

Notional amounts of structured products with options	Value in Euros	Notional	Currency
Interest rate options Caps & Floors	**2,236**		
Caps&Floors	**2,236**		
USD	23	28	USD
EUR	1,250	1,250	EUR
GBP	963	750	GBP
Currency options	**2,350**		
GBPEUR	797	797	EUR
USDEUR	1,553	1,885	USD
Subtotal	**4,586**		
TOTAL	**162,926**		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	**260**	**–**	**60**	**–**	**200**
Loans	**33,111**	**3,863**	**6,191**	**8,597**	**14,460**
in national currency	22,785	2,850	3,500	5,450	10,985
in foreign currencies	10,326	1,013	2,691	3,147	3,475
Debentures and bonds MtM	**79,792**	**8,701**	**26,511**	**13,636**	**30,944**
in national currency	34,948	2,750	12,748	8,350	11,100
in foreign currencies	44,844	5,951	13,763	5,286	19,844
Without underlying*	**49,763**	**27,216**	**11,183**	**4,370**	**6,994**
CCS	1,201	680	521	–	–
Currency options	3,595	1,323	2,151	121	–
Forward	10,556	10,556	–	–	–
IRS	34,411	14,657	8,511	4,249	6,994
Total	**162,926**	**39,780**	**43,945**	**26,603**	**52,598**

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.

The debentures and bonds hedged relate to both those issued by Telefónica, S.A. and intragroup loans on the same terms as the issues of Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

The fair value of Telefónica, S.A.'s derivatives portfolio with external counterparties at December 31, 2015 was equivalent to a net asset of 3,513 million euros (net asset of 1,999 million euros in 2014).

b) Risk management policy

Telefónica, S.A. is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting Telefónica are as follows:

Exchange rate risk

Foreign currency risk primarily arises in connection with: (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America and in the United Kingdom), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.

Interest rate risk

Interest rate risk arises primarily in connection with changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of non-current liabilities at fixed interest rates.

Share price risk

Share price risk arises primarily from changes in the value of the equity investments (that may be bought, sold or otherwise involved in transactions), from changes in the value of derivatives associated with such investments, from changes in the value of treasury shares and from equity derivatives.

Other risks

Telefónica, S.A. is also exposed to liquidity risk if a mismatch arises between its financing needs (operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (revenues, divestments, credit lines from financial institutions and capital market operations). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, Telefónica is exposed to country risk (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica, S.A. operates, especially in Latin America.

Risk management

Telefónica, S.A. actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to stabilizing cash flows, the income statement and investments. In this way, Telefónica attempts to protect its solvency, facilitate financial planning and take advantage of investment opportunities.

Telefónica manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. Telefónica believes that these parameters are more appropriate to understanding its debt position. Net debt and net financial debt take into account the impact of the Group's cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by Telefónica should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of leverage.

Exchange rate risk

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies and/or synthetic debt in such currencies. This objective is also reflected on the decrease of the sensitivity to exchange rate variations of the net debt to OIBDA ratio, in order to protect the Group solvency. The degree of exchange rate hedging employed varies depending on the type of investment. For transactions of purchase or sale of business in currencies other than euro, additional hedges can be made on the estimate prices of the transactions or on estimated cash flows and OIBDA.

Telefónica occasionally takes out dollar-denominated debt to hedge the euro-dollar intermediate component in the relation Euro-Latin American currencies, either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent.

Pound sterling-denominated net debt at December 31, 2015, amounted to 6,988 million euros equivalent, with a significant increase over the year in the context of the agreement for the sale of Telefonica´s operation in the United Kingdom.

Exchange rate risk is managed by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether there are open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

As Telefónica's direct exposure is counterbalanced by the positions held in subsidiaries, the Company analyses its foreign currency risk exposure at the Group level. To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2015 were constant during 2016 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that consolidated exchange losses recorded for 2015 would be a negative 24 million euros. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to a decrease in finance costs of 22 million euros. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

Interest rate risk

The Telefónica Group's financial expenses are exposed to changes in interest rates. In 2015, the rates applied to the largest amount of short-term debt were mainly based on the Euribor and the dollar Libor. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest rate options.

Telefónica analyzes its exposure to changes in interest rates at the Telefónica Group level. The table illustrates the sensitivity of finance costs and the balance sheet to variability in interest rates at Group and Telefónica, S.A. level.

To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2015 has been assumed, as well as a 100 basis point decrease in all currencies (EUR, GBP, USD, etc.) in order to avoid negative rates. The constant position equivalent to that prevailing at the end of the year has also been assumed.

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2015 was assumed, as well as a 100 basis point decrease in all currencies and terms (except those below 1% in order to avoid negative rates). Cash flow hedge positions were also considered as they are the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

In both cases, only transactions with external counterparties have been considered.

	Impact on Consolidated net income (*)	Impact on P/LTelefónica, S.A. (*)	Impact on Consolidated Equity	Impact on Telefónica, S.A. Equity
+100bp	(245)	(127)	145	183
-100bp	75	29	98	55

(*) Impact on results of 100 bp change in all currencies, except the pound sterling, the dollar, the euro and the czech crown.

Share price risk

The Telefónica Group is exposed to changes in the value of equity investments, from changes in the value of derivatives associated with such investments, from convertible or exchangeable instruments issued by Telefónica Group, from Share-based payments plans, from treasury shares and from equity derivatives over treasury shares.

According to the Share-based payments plans (see Note 19) the shares to be delivered to employees under such plan may be either the parent company treasury shares, acquired by them or any of its Group companies; or newly-issued shares. The possibility of delivering shares to beneficiaries of the plan in the future, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each phase, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each phase if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for ordinary shareholders as a result of the higher number of shares delivered under such plan outstanding.

In 2015 a new long-term incentive Plan consisting of the delivery of shares of Telefónica, S.A. aimed at members of the Executives of Telefónica Group was launched denominated Performance and Investment Share Plan (PIP). Furthermore 2014 Ordinary General Shareholders' Meeting approved a Global incentive Telefónica, S.A. shares purchase Plan for the Employees of the Telefónica Group.

To reduce the risk associated with variations in share price under these plans, Telefónica could acquire instruments that hedge the risk profile of some of these plans.

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2015 to cover shares deliverable under the PIP or the Global Employee Share Plan. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

Liquidity risk

The Telefónica Group seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

1. The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.
2. The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (although drawing upon firm credit lines arranged with banks), assuming budget projections are met.

Country risk

The Telefónica Group managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Credit risk

The Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. generally trades with credit entities whose "senior debt" ratings are of at least "A-" or in case of Spanish entities in line with the credit rating of Kingdom of Spain. In Spain, where most of the Group's derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. In addition, the CDS (Credit Default Swap) of all the counterparties with which Telefónica, S.A. operates is monitored at all times in order to assess the maximum allowable CDS for operating at any given time. Transactions are generally only carried out with counterparties whose CDS is below the threshold.

CVA or Credit Valuation Adjustment is the method used to measure credit risk for both counterparties and Telefonica in order to determine the fair value of the derivatives portfolio. This adjustment reflects the probability of default or the deterioration of the credit quality of both Telefonica and its counterparties. The simplified formula to calculate CVA is Expected Exposure times Probability of Default times Loss Given Default. In order to calculate these variables standard market practices are used.

For other subsidiaries, particularly those in Latin America, assuming a stable sovereign rating provides a ceiling which is below "A", trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually. Counterparties are chosen according to criteria of liquidity, solvency and diversification based on the conditions of the market and countries where the Group operates. The general framework sets: the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); and the instruments in which the surpluses may be invested (money-market instruments).

The Telefónica Group considers credit risk management as a key element to achieve its business and customer base growth targets in a manner that is both sustainable and consistent with Telefónica Corporate Risk Management Policy. This management approach relies on the active monitoring of the risk-reward balance in the commercial operations and the adequate separation between the risk ownership areas and risk management areas.

Debtors that could cause a material impact on the Group's consolidated financial statements and increased risk profile products – due to customer targets, term, channels or other commercial characteristics - are subject to specific management practices in order to mitigate the exposure to credit risk.

Uniform policies, procedures, delegation of authority and management practices are established in all Group companies, taking into account benchmark risk management techniques but adapted to the local characteristics of each market. This commercial credit risk management model is embedded into the Group's decision-making processes, especially from a day-to-day operating perspective, where the credit risk profile guides both the product and services available for the different customers and the collections strategy.

Telefónica's maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 8 and 9) and the guarantees given by Telefónica.

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2015, these guarantees amounted to approximately 107 million euros .

Capital management

Telefónica's corporate finance department takes into consideration several factors for the evaluation of the Telefónica's capital structure, with the aim of maintaining the solvency and creating value to the shareholders.

The corporate finance department estimates its cost of capital monitoring the financial markets and applies to standard industry approaches for calculating weighted average cost of capital, or WACC, in order to be applied for the valuation of businesses in course and to the evaluation of the investment projects. Telefónica also uses a net financial debt ratio below 2.35x OIBDA in the medium term (excluding items of a non-recurring or exceptional nature), aiming at protecting the credit rating over the medium term, and allowing for alternative cash flow uses that could arise at any time.

These general factors are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, or the volatility in cash flow generation, when evaluating the Telefónica Group's financial structure and its different areas.

Derivatives Policy

Telefónica's derivatives policy emphasizes the following points:

- Derivatives based on a clearly identified underlying.
- Matching of the underlying to one side of the derivative.
- Matching the company contracting the derivative and the company that owns the underlying.
- Ability to measure the derivative's fair value using the valuation systems available to the Telefónica Group.
- Sale of options only when there is an underlying exposure.

Hedge accounting

Hedges can be of three types:

- Fair value hedges
- Cash flow hedges, which can be set at any value of the risk to be hedged (primarily interest rate and foreign currency) or for a defined range through options.
- Hedges of net investment in a foreign operation.

Hedges can comprise a combination of different derivatives. There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through to maturity. Hedging relationships may change to allow appropriate management that serves our stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting our share capital. The designation of hedges may therefore be cancelled, before maturity, because of a change in the underlying, a change in perceived risk on the underlying or a change in market view. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented. To gauge the efficiency of transactions defined as accounting hedges, we analyze the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model for both forward- and backward-looking analysis.

Risk management guidelines are issued by the Corporate Finance Department. This department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks.

In 2015 the Company recognized a loss of 63 million euros for the ineffective part of cash flow hedges (0.25 million euros in 2014).

The fair value of Telefónica, S.A. derivatives with third parties amounted to a positive MTM (accounts receivable) of 3,513 million euros in 2015 (1,999 million euros in 2014).

The fair value of Telefónica, S.A. intragroup derivatives amounted to a negative MTM (accounts payable) of 113 million euros in 2015 (14 million euros in 2014).

The breakdown of the Company's derivatives with counterparties not belonging to the Telefónica Group at December 31, 2015 and 2014 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

2015

Millions of euros	Fair value (**)	Notional amount maturities (*)				
Derivatives		2016	2017	2018	Subsequent years	Total
Interest rate hedges	**(650)**	**1,360**	**210**	**(363)**	**(2,521)**	**(1,314)**
Cash flow hedges	427	(75)	460	250	2,100	2,735
Fair value hedges	(1,077)	1,435	(250)	(613)	(4,621)	(4,049)
Exchange rate hedges	**(1,429)**	**(3,947)**	**891**	**1,170**	**2,936**	**1,050**
Cash flow hedges	(1,429)	(3,947)	891	1,170	2,936	1,050

Fair value hedges	–	–	–	–	–	–
Interest and exchange rate hedges	**(1,100)**	**355**	**111**	**367**	**5,387**	**6,220**
Cash flow hedges	(1,100)	355	111	367	5,387	6,220
Net investment Hedges	**–**	**–**	**–**	**–**	**–**	**–**
Other derivatives	**(334)**	**(2,738)**	**(187)**	**(312)**	**(1,562)**	**(4,799)**
Interest rate	(85)	(1,882)	(289)	(399)	(1,526)	(4,096)
Exchange rate	(527)	(1,264)	(201)	87	(36)	(1,414)
Other	278	408	303	–	–	711

(*) For interest rate hedges, the positive amount is in terms of fixed "payment." For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

2014

Millions of euros	Fair value (**)	Notional amount maturities (*)				
Derivatives		2015	2016	2017	Subsequent years	Total
Interest rate hedges	**(471)**	**(1,000)**	**2,045**	**210**	**(2,928)**	**(1,673)**
Cash flow hedges	665	(1,000)	800	460	3,350	3,610
Fair value hedges	(1,136)	–	1,245	(250)	(6,278)	(5,283)
Exchange rate hedges	**(809)**	**4,718**	**3,141**	**913**	**3,799**	**12,571**
Cash flow hedges	(809)	4,718	3,141	913	3,799	12,571
Fair value hedges	–	–	–	–	–	–
Interest and exchange rate hedges	**(453)**	**(221)**	**549**	**228**	**2,767**	**3,323**
Cash flow hedges	(453)	(221)	549	228	2,767	3,323
Net investment Hedges	**(65)**	**(726)**	**(588)**	**–**	**–**	**(1,314)**
Other derivatives	**(201)**	**7,385**	**(111)**	**(1,243)**	**(1,437)**	**4,594**
Interest rate	34	7,893	452	(325)	(1,557)	6,463
Exchange rate	(192)	(481)	(563)	(168)	120	(1,092)
Other	(43)	(27)	–	(750)	–	(777)

(*) For interest rate hedges, the positive amount is in terms of fixed "payment." For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

Note 17. Income tax

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2015 and 2014 comprised 52 and 49 companies, respectively.

Consolidated tax group is valid during an indefinite period as long as the law requirements are fulfilled, or the Company decides to expressly resign to it.

Tax balances as of December 31, 2014 and 2015 are as follows:

Millions of euros	2015	2014
Tax receivables:	**6,439**	**4,943**
Deferred tax assets:	**6,153**	**4,289**
Deferred income tax (income)	3,444	3,096
Long-term tax credits for loss carryforwards	2,077	1,167
Unused tax deductions	632	26
Current tax receivables (Note 10):	**286**	**654**
Withholdings	36	66
Corporate income tax payable	229	574
VAT and Canary Islands general indirect tax refundable	21	14
Tax payable:	**172**	**254**
Deferred tax liabilities:	**88**	**179**
Current payables to public administrations (Note 18):	**84**	**75**
Personnel income tax withholdings	4	1
Corporate income tax payable	12	12
Withholding on investment income, VAT and other	67	61
Social security	1	1

Telefónica, S.A. has tax credits for loss carryforwards, unused by Tax Group in Spain at December 31, 2015 amounting to 8,557 million euros:

2015/12/31	Total	Less than 1 year	More than 1 year
Tax Group tax credits for loss carryforwards	**8,306**	-	8,306
Prior to Tax Group tax credits for loss carryforwards (*)	**251**	-	251

(*) Unused tax credits for loss carryforwards

Total tax credits based on the taxable income recognized in the balance sheet at December 31, 2015 therefore amount to 2,077 million euros (1,167 million euros in 2014).

During 2015, Telefónica, S.A., as head of the Telefónica tax group, made payments on account of 2015 income tax amounting to 47 million euros (270 million euros in 2014).

17.1 Movement in deferred tax assets and liabilities

The balances and movements in “Deferred tax assets” and “Deferred tax liabilities” for Telefónica, S.A. at December 31, 2015 and 2014 are as follows:

2015

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	**1,167**	**3,096**	**26**	**4,289**	**179**
Arising in the year	1,801	1,330	–	3,131	10
Reversal	–	(994)	(526)	(1,520)	(71)
Transfers to the tax group's net position	(891)	12	1,132	253	(30)
Closing balance	**2,077**	**3,444**	**632**	**6,153**	**88**

2014

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	**1,203**	**3,115**	**7**	**4,325**	**262**
Arising in the year	34	536	–	570	–
Reversal	–	(560)	(15)	(575)	(92)
Transfers to the tax group's net position	(70)	5	34	(31)	(6)
Other movements	–	–	–	–	15
Closing balance	**1,167**	**3,096**	**26**	**4,289**	**179**

Additions of deferred tax assets include, among others, capitalization of tax credits according to the evolution of litigation and Tax inspections opened to the Tax Group in Spain as detailed in Note 17.3. The capitalized amount totaled 1,157 million euros, corresponding to the recognition of all the tax credits for loss carryforwards generated within the tax group in Spain that were unused at beginning of 2015, and the tax credit for the negative taxable base resulting from the calculation of the 2015 Income tax provision, amounting to 644 million euros.

The main items for which Telefónica, S.A. recognizes temporary differences in assets and liabilities are the effects of impairment losses on some of its assets, principally investments (see Note 8). Among others, the tax effect of the adjustment of the value of the investment of Telefónica, S.A. in Telefónica Europe, p.l.c. of 604 million euros (total amount for this concepts is 1,789 million euros, and it is due to be recovered when the highly probable sale transaction is completed), and in Sao PauloTelecomunicaçoes Participaçoes, Ltda., of 561 million euros, registered as additions, or the disposal registered as a consequence of the partial spin off of Telco S.p.A. which has allowed to set off against tax the capital loss produced by the difference between the acquisition value and the market value of the stake, as of the spin off date, amounting to 744 million euros.

On the occasion of the settlement made by the tax inspection in Spain of the income tax for the years 2008 to 2011, the original income tax clearance was modified. The change in the clearance involved the use of tax losses carryforwards credits, instead of deductions, which appear unused again by the tax group. Moreover, the impact of the settlements on Spanish income tax inspections on years 2001 to 2004 and 2008 to 2011 are also included as described in 17.3. The whole effect in the Tax Group amounts to 170 million euros. The figure is shown as “Transfers to the tax group’s net position”.

Based on Spanish tax group companies’ business plans, besides the best available estimation of taxable income, within an appropriate term to the market situation where the companies operate, the Group has written down 526 million euros of deductions, and alternatively has registered tax credits derived from the above mentioned tax losses carryfoward.

The amount of Telefonica S.A.’s deductions pending to be registered stands as of December 31st at 635 million euros.

The movements relating deferred tax recognized directly in equity amounted to 12 million euros of additions and 151 million euros of disposals.

17.2 Reconciliation of accounting profit to taxable income and income tax expense to income tax payable.

The calculation of the income tax expense and income tax payable for 2015 and 2014 is as follows.

Millions of euros	2015	2014*
Accounting profit before tax		
from continued operations	**(1,496)**	**3,140**
from discontinued operations	**(815)**	**(1,151)**
Permanent differences	(2,818)	(5,472)
Temporary differences:	374	1,650
Arising in the year	3,541	1,554
Arising in prior years	(3,167)	96
Tax result	**(4,755)**	**(1,833)**
Gross tax payable	(1,331)	(550)
Corporate income tax refundable	**(1,331)**	**(550)**
Capitalization losses carry forward/write down deductions	(631)	(34)
Temporary differences for tax valuation	(322)	(487)
Temporary differences derived from the consolidation process	–	(8)
Other effects	(52)	484
Corporate income tax accrued in Spain	(2,336)	(595)
Foreign taxes	17	(21)
Income tax		
continued operations	**(2,102)**	**(698)**
Current income tax	(618)	(561)
Deferred income tax	(1,484)	(137)
discontinued operations	**(217)**	**83**

(*) Revised data see Note 2

The permanent differences relate mainly to changes in investment in Group Companies write-down provisions recorded by the Tax Group companies included in the consolidated corporate income tax return, dividends received and investment write downs with no deferred asset registered.

Temporary differences mainly refer to adjustment made to Tax result due to accruals or reversals of non-deductible investment write downs whose correspondent deferred tax has been registered.

The caption “capitalization losses carry forward/write down deductions” includes mainly the effect of the recognition of tax credits amounting 1,157 million euros and the write down of deductions amounting to 526 million euros after the above mentioned recovery analysis.

The caption “other effects” includes the effect derived from Spanis Tax inspections during 2015, and the tax provision related to the tax deductibility of the goodwill amortization (see Note 17.3)

Additionally, Telefonica S.A. approved in 2015 a donation to the Telefonica Foundation amounting to 325 million euros, which generated a deferred tax asset of 130 millon euros registered in the same caption.

17.3 Tax inspections and tax-related lawsuits

With regard to the tax inspection for the years 2001 to 2004, the Supreme Court issued a ruling in 2015, accepting the tax losses incurred by the Group in relation to the transfer of certain interests in TeleSudeste, Telefónica Móviles México and Lycos as tax deductible, rejecting the other contentions, and therefore the contingencies related to this process disappeared. This has resulted in recognition of a tax expense of 49 million euros in the 2015 financial statements (1 million euros in Telefónica, S.A.'s standalone annual accounts). However, this did not require payment of any tax because the Company applied unused tax credits for loss carryforwards to offset the effect of these adjustments, at the corresponding tax rate for each period.

In 2012, tax inspections for all taxes for the years 2005 to 2007 were completed, with the Company signing off a corporate income tax assessment of 135 million euros, which was paid in 2012, whilst disputing other adjustments with which it disagreed. Although the settlement agreement for the disputed tax assessment did not give rise to any tax payment, since the adjustments proposed were offset by unused tax credits for loss carryforwards, the Company filed an appeal with the Central Economic-Administrative Court against these adjustments in May 2015, regarding the tax treatment of the "juros sobre el capital propio" (interest on own capital) as dividends.

On the other hand, in July 2015, tax inspections for all taxes for the years 2008 to 2011 were completed, with the Company signing off certain corporate income tax assessments and disputing others. This resulted in an expense amounting to 206 million euros euros (80 million euros in Telefónica, S.A.'s standalone annual accounts). However, this did not require any tax payment, as the adjustments arising from the inspection were offset by unused tax credits for loss carryforwards, at the corresponding tax rate for each period.

Although the settlement agreement for the disputed tax assessment did not give rise to any tax payment, in July 2015 the Company filed an appeal with the Central Economic-Administrative Court against the adjustments it disputes, regarding the tax treatment of the "juros sobre el capital propio" (interest on own capital) as dividends, and the criteria to use tax credits for loss carryforwards in the years subject to settlement.

At 2015 year end, it is not expected that there is any need to recognize additional liabilities for the outcome of this litigation.

Tax deducibility of financial goodwill (Article 12.5)

Spain added a new Article 12.5 to its Corporate Income Tax Law, which came into force on January 1, 2002. The article regulated the deductibility of tax amortization of financial goodwill arising from the acquisition of non-Spanish companies, which could be amortized over 20 years at 5% per annum. Following the entry into force of the Laws 9/2011 of August 19, 2011 and 16/2013 of October 29, 2013, the amount of goodwill amortization deductible for tax purposes under article 12.5 for the years 2011 to 2015 was reduced from 5% to 1%. The effect is temporary because the 4% not amortized during 5 years (20% in total) will be recovered extending the deduction period from the initial 20 years to 25 years.

The Telefónica Group, under this standard, has been amortizing for tax purposes the financial goodwill from its investments, both direct and indirect, in O2, BellSouth and Coltel (prior to December 21, 2007) and Vivo (acquired in 2010). The positive accumulated tax effect in the corresponding settlements of Corporate Income Tax from 2004 to the closing of December 31, 2015, was 899 million euros.

Worthy of note is the fact that in relation to this tax incentive, the European Commission has in recent years commenced three proceedings against the Spanish State as it deems that this tax benefit could constitute State Aid. Although the Commission itself acknowledged the validity of its first two decisions for those investors that invested in European companies (for operations carried out before December 21, 2007 in the first decision, and before May 21, 2011 for investments in other countries in the second decision) in the third case (concluded October 15, 2014), it calls into question the applicability of the principle of legitimate expectations in the application of the incentive for indirect acquisitions, whatever the date of acquisition may have been.

However, at the issuance date of these financial statements the three decisions are pending of final ruling: the first two have been annulled by two Judgments of the Court of First Instance of the European Union and they have been appealed by the Commission, and the third is pending a judgment at first instance. Furthermore, there are doubts in the Spanish courts regarding the classification of the incentive as a deduction and its maintenance in the case of subsequent transmission (see Note 23). The Telefónica Group has decided to set up a provision of the amount relating to the goodwill amortized for tax purposes corresponding to the purchase of companies of the O2 Group subject to a transfer agreement and to continue provisioning, as to date, that relating to Vivo, for a total of 377 and 75 million euros, respectively (see Note 15). The amount relating to the companies of the O2 Group was recognized under "Profit after tax from discontinued operations" (see Note 22).

Note 18. Trade, other payables and provisions

A) Trade and other payables

The breakdown of "Trade and other payables" is as follows:

Millions of euros	2015	2014
Suppliers	134	140
Accounts payable to personnel	48	42
Other payables	353	79
Current income tax liabilities (Note 17)	12	12
Other payables to public administrations (Note 17)	72	63
Total	**619**	**336**

Other payables

This line includes Telefónica's irrevocable commitment to pay a 325 million euros donation to Fundación Telefónica to provide this entity with the financing required to enable the foundation to operate in the short and medium term, providing this entity therefore with the funding required to implement the social programs and activities it currently performs or could initiate in the short and medium term to fulfill its purpose as a foundation.

Information on deferred payments to third parties. (Third additional provision, "Information requirement" of Law 15/2010 of 5 July).

In accordance with the aforementioned Law, the following information corresponding to the Company is disclosed:

	2015 Number of days
Weitghted average maturity period	24
Ratio of payments	26
Ratio of outstanding invoices	11

	Million of euros
Total Payments	345
Outstanding invoices	36

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree 4/2013, amending Law 3/2004, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers, as contractually agreed with them, in 2015 included payment periods of up to 60 days.

For reasons of efficiency and in line with general practice in the business, the Company has set payment schedules, whereby payments are made on set days. Invoices falling due between two payment days are settled on the following payment date in the schedule.

Payments to Spanish suppliers in 2015 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the delay in the billing process (a legal obligation for the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

B) Provisions

In 2015 and 2014 the concepts and amounts under the provision captions are the following:

2015

Millions of euros	Non-current	Current	Total
Tax Provisions	455	-	455
Negative net book value of investments (Note 8)	186	-	186
Termination plans (Note 19)	81	39	120
Other provisions	112	4	116
Total	**834**	**43**	**877**

2014

Millions of euros	Non-current	Current	Total
Negative net book value of investments (Note 8)	155	-	155
Personnel expenses related provisions	-	7	7
Other provisions	112	39	151
Total	**267**	**46**	**313**

Movements in the provisions during 2015 and 2014 are disclosed below:

Millions of euros	2015	2014
Opening balance:	**313**	**225**
Additions	501	174
Amortization and reversals	(45)	(64)
Transfers	106	3
Fair value adjustments and others	2	(25)
Closing balance:	**877**	**313**
Maturity:		
Non-current	753	267
Current	124	46

The caption "additions" includes in 2015 the 381 million of euros accrual for 12.5 deduction described in Note 17. This concept had already been partially accrued in 2014 by 75 million euros and was registered as Deferred Tax and it has been transferred to Long Term Tax Provisions in 2015. It has been shown as "Transfers" in the chart above.

Besides the concept described in the previous paragraph, under "transfers" it is shown the decrease in the valuation of certain investment in group companies and associates which have a negative book value (see Note 8).

Within the framework of the simplification and transformation process of the Telefónica Group, Telefónica, S.A. has launched a voluntary termination plan ending in 2017, for the employees who meet the requeriments defined by the Plan regarding age and seniority in the Company, among others. The amount accrued totals 120 milion euros and it has been shown as additions in the table of movements above (see Note 19).

Given the nature of the risks covered by these provisions, it is not possible to determine a reliable schedule of potential payments, if any.

Note 19. Revenue and expenses

19.1 Revenue

a) Rendering of services

Telefónica, S.A. has contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2015 and 2014, "Rendering of services to Group companies and associates" included 511 million euros and 553 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica O2 Holding, Ltd. and Telefónica Internacional, S.A.U. Revenue received for this concept in 2015 and 2014 amounted to 29 million euros in both years, recognized under "Rendering of services to Group companies and associates".

Revenues also include property rental income amounting to 48 and 49 million euros in 2015 and 2014, respectively, mainly from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

b) Dividends from Group companies and associates

The detail of the main amounts recognized in 2015 and 2014 is as follows:

Millions of euros	2015	2014
Telefónica Internacional, S.A.U.	1,000	3,238
Telefónica de España, S.A.U.	1,601	1,999
Telefónica Móviles España, S.A.U.	718	994
Telefônica Brasil, S.A.	371	255
Telefónica Latinoamérica Holding, S.L.	341	–
Sao Paulo Telecommunicaçoes	85	56
Telfin Ireland, Ltd.	705	–
Telefónica Centroamérica Inversiones, S.A.	42	19
Taetel, S.A.U.	94	–
Telefónica y Finanzas, S.A.U.	98	–
Other companies	116	109
Total	**5,171**	**6,670**

c) Interest income on loans to Group companies and associates

This heading includes the return obtained on loans made to subsidiaries to carry out their business (see Note 8.5). The breakdown of the main amounts is as follows:

Millions of euros	2015	2014
Telefónica Móviles México, S.A. de C.V.	42	54
Telefónica de España, S.A.U.	18	20
Telefónica Internacional, S.A.U.	34	–
Telefónica Móviles Argentina, S.A.	25	8
Other companies	43	25
Total	**162**	**107**

19.2 "Non-core and other current operating revenues – Group companies" relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion.

19.3 Personnel expenses and employee benefits

The breakdown of "Personnel expenses" is as follows:

Millions of euros	2015	2014
Wages, salaries and other personnel expenses	284	203
Pension plans	10	8
Social security costs	21	22
Total	**315**	**233**

In 2015, "Wages, salaries and other personnel expenses" includes 126 million euros of compensation payable during the year (18 million euros in 2014). The outstanding figure of this concept at the closing balance has been described in Note 18.

Telefónica has reached an agreement with its staff to provide an Occupational Pension Plan pursuant to Legislative Royal Decree 1/2002, of November 29, approving the revised Pension Plans and Funds Law. The features of this plan are as follows:

- Defined contribution of 4.51% of the participating employees' base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España, S.A.U.) will be maintained.
- Mandatory contribution by participants of a minimum of 2.2% of their base salary.
- Individual and financial capitalization systems.

This fund was outsourced to Telefónica subsidiary, Fonditel Entidad Gestora de Fondos de Pensiones, S.A., which has added the pension fund assets to its Fonditel B fund.

At December 31, 2015, 1,960 employees had signed up for the plan (1,896 employees in 2014). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 3 million euros in 2015 (4 million euros in 2014).

In 2006, a Pension Plan for Senior Executives, wholly funded by the Company, was created and complements the previous plan and involves additional defined contributions at a certain percentage of the executive's fixed remuneration, based on professional category, plus some extraordinary contributions depending on the circumstances of each executive, payable in accordance with the terms of the plan.

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 9 million euros both in 2015 and 2014.

In 2015, some executives left this Pension Plan for Senior Executives, leading to the recovery of the cost of the contributions corresponding to these executives amounting to 2 million euros (4 million euros in 2014).

No provision was made for this plan as it has been fully externalized.

The share-based payment plans are the following:

Long-term incentive plan based on Telefónica, S.A. shares: "Performance and Investment Plan"

At the General Shareholders' Meeting held on May 18, 2011, a new long-term share-based incentive plan called "Performance and Investment Plan" (the "Plan" or "PIP") was approved for Telefónica Group directors and executive officers.

Under this Plan, a certain number of shares of Telefónica, S.A. will be delivered to participants selected by the Company who have opted to take part in the scheme and meet the requirements and conditions stipulated to this end. The plan includes an additional condition regarding compliance by all or part of the Participants with a target investment and holding period of Telefónica, S.A. shares through each phase ("Co-Investment").

The term of the plan is five years and it is divided into three phases.

The second phase expired on June 30, 2015. The maximum number of shares assigned to this phase of the plan was 7,347,282 shares assigned on July 1, 2012, with a fair value of 5.87 euros per share. At the end of the phase, according to the general conditions of the plan, a 77% of achievement of the *"Total Shareholder Return" (TSR)* was determined. Therefore, a total of 2,724,699 shares were delivered to Telefónica Group directors (corresponding to a total of 3,691,582 gross shares less a withholding of 966,883 shares at the choice of employees).

Regarding the third allocation of shares under this plan, the maximum number of shares assigned (including the amount of co-investment) and the number of shares outstanding at December 31, 2015 is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/14	Unit fair value	End date
3rd phase July 1, 2013	7,020,473	5,641,623	6.40	June 30, 2016

From the total number of shares assigned, 2,350,769 shares were assigned to employees of Telefónica, S.A. in phase 3.

At the General Shareholders' Meeting held on May 30, 2014, the second long-term share-based incentive plan called "Performance and Investment Plan" (the "Plan" or "PIP") was approved for Telefónica Group directors and executive officers. This plan will take effect following completion of the first "Performance Investment Plan" with the same conditions as the previous PIP share plan.

The maximum number of shares assigned (including the amount of co-investment) and the number of shares outstanding at December 31, 2015 is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/15	Unit fair value	End date
1st phase October 1, 2014	6,927,953	6,316,281	6.82	September 30, 2017
2nd phase October 1, 2014	6,775,445	6,771,146	6.46	September 30, 2018

Out of the total figure of shares assigned at 12/31/2015, 2,477,390 and 2,567,397 shares correspond to employees of Telefónica, S.A. in phases 1 and 2, respectively.

Long-term incentive plan based on Telefónica, S.A. shares: "Talent for the Future Share Plan" (TFSP).

At the General Shareholders' Meeting held on May 30, 2014, a long-term share-based incentive plan called "Talent for the Future Share Plan" was approved for certain Telefónica Group employees.

The plan has been implemented for employees with persistently outstanding performance, high potential and key skills who are expected to take leading roles in the future, by granting a stake in the share capital of the Company consisting in the awarding, to participants who meet the requirements and conditions stipulated to this end, of a certain number of shares assigned that will serve as reference for the calculation, where appropriate, depending on the level of compliance of the objective of the Plan, the shares to be delivered.

Through the implementation of TFSP, the Company intends to link the interests of the participants to those of the shareholders of Telefónica, as well as acknowledge and reward their contribution to the results of Telefónica.

The term of the plan is five years and it is divided into three cycles.

The maximum number of shares assigned and the number of shares outstanding at December 31, 2015 is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/15	Unit fair value	End date

1st phase October 1, 2014	556,795	556,795	6.82	September 30, 2017
2nd phase October 1, 2014	618,000	618,000	6.46	September 30, 2018

Out of the total figure of shares assigned at 12/31/2015, 72,768 and 75,500 shares correspond to employees of Telefónica, S.A. in phases 1 and 2, respectively.

Telefónica, S.A. share plan: "Global Employee Share Plan" (GESP)

The Telefónica, S.A. Ordinary General Shareholders' Meeting on May 18, 2011 approved a voluntary plan for incentivized purchases of Telefónica, S.A. shares for all employees of the Telefónica Group worldwide, with certain exceptions. Under this plan, participants who met certain requirements were offered the possibility of buying shares in Telefónica, S.A., which undertook to deliver them a certain number of free shares.

The plan's share holding period came to an end in December 2014. More than 21,000 employees on the scheme were rewarded with a total of 1,778,099 shares from Telefónica, valued at approximately 20 million euros at the time they were delivered with effect in equity (see Note 11.1).

Likewise, the Telefónica, S.A. Ordinary General Shareholders' Meeting on May 30, 2014 approved a new voluntary plan for incentivized purchases of shares for the employees of the Group Under this Plan, employees were offered the option to acquire Telefónica, S.A. shares during a twelve month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements. Each employee was limited to buying a maximum of 1,800 euros in Telefónica, S.A. shares, subject to a minimum of 300 euros. If the employee remains part of the Telefónica Group and holds on to the shares for one year following the acquisition period (the shareholding period), they will be entitled to receive one free share for each share they acquire and retain throughout the shareholding period.

The acquisition period started in July 2015. As of December 31, 2015, 32,414 employees had registered for the plan. The plan will be settled through the delivery of shares to employees.

19.4 Average number of employees in 2015 and 2014 and number of employees at year-end:

2015

	Employees at 12/31/15			Average no. of employees in 2015		
Professional category	Females	Males	Total	Females	Males	Total
General managers and chairmen	-	1	1	-	1	1
Directors	61	140	201	58	137	195
Managers	150	162	312	145	154	299
Project Managers	169	112	281	168	112	280
University graduates and experts	107	68	175	101	60	161
Administration, clerks, advisors	128	2	130	121	3	124
Total	**615**	**485**	**1,100**	**593**	**467**	**1,060**

2014

	Employees at 12/31/14			Average no. of employees in 2014		
Professional category	Females	Males	Total	Females	Males	Total
General managers and chairmen	-	1	1	-	1	1
Directors	57	154	211	57	147	204
Managers	137	144	281	131	140	271
Project Managers	161	113	274	157	107	264
University graduates and experts	93	56	149	90	54	144
Administration, clerks, advisors	106	8	114	120	8	128
Total	**554**	**476**	**1,030**	**555**	**457**	**1,012**

19.5 External services.

The items composing "External services" are as follows:

Millions of euros	2015	2014
Rent	12	11
Independent professional services	185	174
Donations (Note 18)	369	3
Marketing and advertising	128	71
Other expenses	62	44
Total	**756**	**303**

On December 19, 2007, Telefónica, S.A. signed a rental contract with a view to establishing the headquarters of the "Telefónica Corporate University". The contract included construction and refurbishment of certain facilities by the lessor. On October 31, 2008, some of the facilities were partially accepted and thus the lease period commenced. The lease period is for 15 years (until 2023), renewable for another five.

Future minimum rentals payable under non-cancellable operating leases without penalization at December 31, 2015 and 2014 are as follows:

Millions of euros	Total	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Future minimum rentals 2015	**39**	**5**	10	10	14
Future minimum rentals 2014	**52**	5	10	11	26

19.6 Finance revenue

The items composing “Finance revenue” are as follows:

Millions of euros	2015	2014
Dividends from other companies	7	4
Other third parties financial revenues and gains on derivative instruments	586	180
Total	**593**	**184**

It is included in 2015 under “other finance revenue” the impacts of the hedges arranged to meet the commitments of the bonds mandatory exchangeable into ordinary shares of Telecom Italia (see Note 9), as well as the valuation of the Equity Swap for Treasury shares described in Note 11.The interests rendered in 2014 by the bonds acquired to Telco, S.p.A. (49 million euros) were included within“other finance revenue” because after the loss of significant influence detailed in Note 9, this financial asset has been reclassified to current credits to third parties. In 2015 this item has been cancelled by Telco, S.p.A. and, therefore, the interests recognized in the income statement are not significant.

19.7 Finance costs

The breakdown of “Finance costs” is as follows:

Millions of euros	2015	2014
Interest on borrowings from Group companies and associates	2,094	2,034
Finance costs payable to third parties and losses on interest rates of financial hedges	710	262
Total	**2,804**	**2,296**

The breakdown by Group company of debt interest expenses is as follows:

Millions of euros	2015	2014
Telefónica Europe, B.V.	471	431
Telefónica Emisiones, S.A.U.	1,589	1,550
Other companies	34	53
Total	**2,094**	**2,034**

Other companies includes financial costs with Telefónica Finanzas, S.A.U. and Telfisa Global, B.V. related to current payables for specific cash needs.

The amount included as “Finance costs payable to third parties and gain (losses) on interest rarte of financial hedges” refers to fair value effects in the valuation of derivative instruments described in Note 16.

19.8 Exchange differences:

The breakdown of exchange losses recognized in the income statement is as follows:

Millions of euros	2015	2014
On current operations	49	33
On loans and borrowings	62	66
On derivatives	1,959	1,049
On other items	60	16
Total	**2,130**	**1,164**

The breakdown of exchange gains recognized in the income statement is as follows:

Millions of euros	2015	2014
On current operations	53	61
On loans and borrowings	511	545
On derivatives	1,549	650
On other items	119	11
Total	**2,232**	**1,267**

The change in exchange gains and losses is basically due to the fluctuations in the main currencies the Company works with. In 2015 US dollar has been strengthened by 12% against euro (13.6% against euro in 2014) just like the pound sterling has been strengthened by 6% (7% in 2014). Brazilian real, by contrast, has been significantly weakened by 34% against euro, reversing 2014 trend (strengthening by 0.2% against euro). These impacts are offset by the hedges contracted to mitigate exchange rate fluctuations.

19.9 Impairment losses on disposal of financial instruments with third parties

The amount included under this caption corresponds, in both years, to the change in valuation of Telco, S.p.A. investments as described in Notes 8 and 9.

The effect of the revaluation in the quotation of Telecom Italia, S.p.A.'s shares in Telco, S.p.A. as described in Note 9.3 (500 million euros) is shown in 2015 net of hedges. The net amount is a financial revenue of 411 million euros.

Note 20. Other information

a) Financial guarantees

At December 31, 2015, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 44,868 million euros (45,742 million euros at December 31, 2014). These guarantees are measured as indicated in Note 4.g).

Millions of euros

Nominal Amount	2015	2014
Debentures and bonds and equity instruments	41,685	41,814
Loans and other payables	1,752	3,432
Other marketable debt securities	1,431	496
Total	**44,868**	**45,742**

The debentures, bonds and equity instruments in circulation at December 31, 2015 issued by Telefónica Emisiones, S.A.U., Telefonica Europe, B.V., Telefónica Finanzas México, S.A. de C.V. and Telefónica Participaciones, S.A.U., were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 41,685 million euros at December 31, 2015 (41,814 million euros at December 31, 2014). During 2015, Telefónica Emisiones, S.A.U. issued debt instruments on capital markets for an equivalent of 1,467 million euros (2,962 million euros in 2014) and 3,292 million euros matured during 2015 (4,055 million euros during 2014).

The main loans and other debts guaranteed by Telefónica, S.A. at December 31, 2015 are: credit facilities obtained by Telefónica Finanzas, S.A. from the European Investment Bank, whose outstanding principal at December 31, 2015 was equivalent to 137 million euros (665 million euros at December 31, 2014). During 2015, it was early prepaid a financing agreement entered into with China Development Bank (CDB) and Industrial and Commercial Bank of China (ICBC) on August 28, 2012 by Telefónica Europe, B.V., whose outstanding principal at December 31, 2014 was 844 million US dollars (equivalent to 714 million euros); and a financing agreement entered into with China Development Bank on January 5, 2012 by Telefónica Europe, B.V., whose outstanding principal at December 31, 2014 was 375 million US dollars (equivalent to 354 million euros). Additionally, it was paid by Telefónica Finanzas, S.A.U. according to installments and the repayment schedule of the financings reducing its guaranteed balance in approximately 528 million euros.

“Other marketable debt securities” includes the guarantee of Telefónica, S.A. relating to the commercial paper issue program of Telefonica Europe, B.V. The outstanding balance of commercial paper in circulation issued through this program at December 31, 2015 was 1,431million euros (496 million euros at December 31, 2014).

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2015, these guarantees amounted to approximately 107 million euros (77 million euros at December 31, 2014).

b) Litigation

Telefónica and its Group companies are party to several lawsuits or proceedings that are currently in progress in the law courts and administrative and arbitration bodies of the various countries in which the Telefónica Group is present.

Considering the reports of the Company's legal advisors regarding these proceedings, it is reasonable to assume that this litigation or cases will not materially affect the financial position or solvency of Telefónica Group.

Among unresolved cases or those underway in 2015 (see Note 17 for details of tax-related cases), the following are of special note:

Appeal against the Decision of the European Commission dated January 23, 2013 to sanction Telefónica for the infringement of Article 101 of the Treaty on the functioning of the European Union

On January 19, 2011, the EC initiated formal proceedings to investigate whether Telefónica, S.A. (Telefónica) and Portugal Telecom SGPS, S.A. (Portugal Telecom) had infringed on European Union anti-trust laws with respect to a clause contained in the sale and purchase agreement of Portugal Telecom's ownership interest in Brasilcel, N.V., a joint venture in which both were venturers and owner of Brazilian company Vivo.

On January 23, 2013, the EC passed a ruling on the formal proceedings. The ruling imposed a fine on Telefónica of 67 million euros, as the EC ruled that Telefónica and Portugal Telecom committed an infraction as stipulated in Article 101 of the Treaty on the Functioning of the European Union for having entered into the agreement set forth in Clause Nine of the sale and purchase agreement of Portugal Telecom's ownership interest of Brasilcel, N.V.

On April 9, 2013, Telefónica filed an appeal for annulment of this ruling with the European Union General Court. On August 6, 2013, the European Union General Court notified Telefónica of the response issued by the European Commission, in which the EC reaffirmed the main arguments of its ruling and, specially, that Clause Nine is a competition restriction. On September 30, 2013, Telefónica filed its reply. On December 18, 2013, the European Commission filed its appeal.

A hearing was held on May 19, 2015, at the European Union General Court and is pending resolution by the Court.

Judicial appeals against the decisions by the Conselho Administrativo de Defesa Econômica (CADE) regarding the acquisition by Telefónica of stakes in Portugal Telecom, SGPS S.A. and Telco, S.p.A.

On December 4, 2013, the Brazilian Antitrust Regulator, CADE announced the two following decisions:

1. To approve, with the restrictions described further below, the acquisition by Telefónica of the entire participation held by Portugal Telecom and PT Móveis-Serviços de Telecomunicações, SGPS, S.A. (the PT Companies) in Brasilcel, N.V., which controlled the Brazilian mobile company, Vivo Participações, S.A. (Vivo).

Such transaction had already been approved by ANATEL (Agencia Nacional de Telecomunicaciones de Brasil) and the closing (which did not require CADE's prior approval at the time), occurred immediately after ANATEL's approval was granted on September 27, 2010.

This decision was granted by CADE subject to the following conditions:

(a) the entry of a new shareholder in Vivo, sharing the control of Vivo with Telefónica in conditions identical to those that were applicable to the PT Companies when they had a participation in Brasilcel N.V., or

(b) that Telefónica ceases to have any direct or indirect financial interest in TIM Participações S.A.

Due to the fulfilment of the conditions set forth in the authorizations granted by ANATEL (on December 22, 2014 and March 12, 2015) and CADE (on March 25, 2015) for the acquisition by Telefônica Brasil S.A of Global Village Telecom S.A and his holding company GVT Participaçoes S.A (collectively GVT), and for the demerger of Telco, the previously mentioned decision of CADE of December 4, 2013 was overridden due to Telefonica's divestment of its total shareholding in Telecom Italia.

In this regard, as described on Note 8, Telefónica delivered 1,110 million ordinary shares of Telecom Italia, S.p.A. (representing 8.2% of its ordinary shares) to Vivendi, S.A., obtaining from Vivendi, S.A. a 4.5% of the total share capital of Telefônica Brasil S.A. and to the sale, by means of an agreement with a financing institution, of 872 million ordinary shares of Telecom Italia S.p.A., representing 6.5% of the ordinary shares of this company, for an amount of 1,025 million euros.

Likewise, Telefónica arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia, S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia, S.p.A., issued by Telefónica in July 2014.

Thus, Telefónica has completed the divestment process of its entire stake in Telecom Italia, S.p.A., in accordance with the regulatory and competition commitments assumed.

2. To impose a fine on Telefónica of 15 million Brazilian reais, for having allegedly breached the spirit and the purpose of the agreement signed between Telefónica and CADE (as a condition to the approval of Telefónica's original acquisition of an interest in Telecom Italia in 2007), due to the subscription of and payment for non-voting shares of Telco, S.p.A. in the capital increase carried out in accordance with the agreement dated September 24, 2013. This Decision also requires Telefónica to divest such non-voting shares of Telco, S.p.A. As indicated above, the divestment by Telefónica of its entire stock participation in Telco, S.p.A. and, consequently, in Telecom Italia, S.p.A. has already been completed.

On July 9, 2014, Telefónica filed a judicial appeal against the abovementioned decision, in connection with the fine imposed.

Other contingencies

Telefónica is currently conducting an internal investigation regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about this matter and intends to cooperate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

c) Commitments

Atento

As a result of the sale agreement of Atento by Telefónica, announced on October 12, 2012 and ratified on December 12, 2012, both companies have signed a Master Service Agreement which regulates Atento's relationship with the Telefónica Group as a service provider for a period of nine years.

By virtue of this Agreement, Atento become Telefónica's preferred Contact Centre and Customer Relationship Management (CRM) service provider, stipulating annual commitments in terms of turnover which updates in line with inflation and deflation that vary from country to country, pursuant to the volume of services Atento has been providing to the entire Group.

In the case of an eventual failure to meet the annual turnover commitments that could result in a compensation, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contract Centre's business margin to the final calculation.

Lastly, the Master Agreement sets forth a reciprocal arrangement, whereby Atento assumes similar commitments to subscribe its telecommunications services to Telefónica.

Agreement for the divestment of Telefónica's operations in the UK (O2 UK)

On March 24, 2015, Telefónica signed an agreement with Hutchison for the acquisition by the latter of Telefónica's operations in the UK (O2 UK) for a price (firm value) of 10,250 million pounds sterling in cash (approximately 14,000 million euros at the exchange rate as of the date of the agreement), composed of (i) an initial amount of 9,250 million pounds sterling (approximately 12,640 million euros as of the date of the agreement) which would be paid at closing and (ii) an additional deferred payment of 1,000 million pounds sterling (approximately 1,360 million euros as of the date of the agreement) to be paid once the cumulative cash flow of the combined company in the United Kingdom has reached an agreed threshold. According to the sale agreement, the price will be adjusted by the debt, the working capital and other defined circumstances that may ultimately arise upon closing of the O2 UK divestiture.

Completion of the transaction is subject to, among other conditions, the approval of the European Commission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties. As of the date of the issuance of these Financial Statements, such conditions have not been met. The European Commission authorization process is ongoing.

These conditions must be satisfied by no later than June 30, 2016 however, this date may be extended until September 30, 2016 in specified circumstances.

Agreement for the sale of the shares of Telefónica Gestión de Servicios Compartidos España, S.A.U., Telefónica Gestión de Servicios Compartidos Argentina, S.A. and T-Gestiona Servicios Contables y Capital Humano, S.A.C.

On December 31, 2015, a shares purchase agreement was concluded between, on one hand, Telefónica, S.A., Telefónica Servicios Globales, S.L.U. and Telefónica Gestión de Servicios Compartidos Perú, S.A.C. (as sellers), and, on the other hand, IBM Global Services España, S.A., IBM del Perú, S.A.C., IBM Canada Limited and IBM Americas Holding, LLC (as purchasers) for the sale of the companies Telefónica Gestión de Servicios Compartidos España, S.A.U., Telefónica Gestión de Servicios Compartidos Argentina, S.A. and Tgestiona Servicios Contables y Capital Humano, S.A.C., for a total price of approximately 22 million euros. This shares purchase agreement is expected to be ratified by the parties at the closing of the transaction on March 1, 2016.

Following the aforementioned shares purchase agreement and in connection with the latter transaction, also, on December 31, 2015, Telefónica subscribed a master services agreement with IBM for the outsourcing of economic-financial and HR activities and functions to be provided to the Telefónica Group during a period of ten years, for a total amount of approximately 450 million euros. Most of the Telefónica Group's subsidiary companies will adhere to that master services agreement.

d) Directors' and senior executives' compensations and other benefits

Board of Directors' and Senior Executives' compensation

The compensation of Telefónica members of the Board of Directors is governed by Article 35 of the Bylaws, which states that the compensation amount that the Company may pay to all of its as members of the Board of Directors and the performance of supervision and collective decision-making duties, shall be fixed by the shareholders at the General Shareholders' Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution among the Directors, by reason of any executive or advisory duties that they perform for the Company, other than the supervision and collective decision-making duties inherent in their capacity as Directors, membership to any committee within the Board, and any other objective circumstances that must be taken into consideration. Furthermore, the Directors shall receive an amount as remuneration for executive functions given or delegated by the Board. This compensation must be in line with Director`s compensation policy approved by the General Shareholders' Meeting.

Accordingly, General Shareholders Meeting, held on April 11, 2003, set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros, including a fixed payment and attendance fees of the Board of Director's Advisory or Control Committees. Total compensation paid to Telefónica's Directors for discharging their duties in 2015 amounted to 3,701,602 euros in fixed compensation and attendance fees.

The compensation of Telefónica, S.A. Directors in their capacity as members of the Board of Directors, the Executive Commission and/or the Advisory and Control Committees consists of a fixed amount payable monthly, and fees for attending the meetings of the Board's Advisory or Control Committees. Executive Directors other than the Chairman do not receive any amounts for their directorships, but only the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

The table below presents the fixed amounts established in 2015 for membership to Telefónica's Board of Directors, Executive Commission and Advisory or Control Committees and the attendance fees of the Advisory or Control Committees:

Compensation of members of the Board of Directors and Board Committees

Amounts in euros			
Position	Board of Directors	Executive Committee	Advisory or Control Committees (*)

Chairman	240,000	80,000	22,400
Vice Chairman	200,000	80,000	–
Executive	–	–	–
Proprietary	120,000	80,000	11,200
Independent	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(*) In addition, the amounts paid for attendance to each of the Advisory or Control Committee's meetings is 1,000 euros.

Individual breakdown

Appendix II provides a detail by individual, by compensation item, of the compensation and benefits paid by Telefónica, S.A. and other companies of the Telefónica Group to members of the Company's Board of Directors in 2015.

e) Related-party transactions

Significant shareholders

The main transactions between Telefónica, S.A. and its significant shareholders – always concluded at arm's length – are as follows: The figures refer to Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries pertaining to its consolidated group and Caja de Ahorros y Pensiones de Barcelona, (la Caixa) and subsidiaries pertaining to its consolidated group: Their stake in Telefónica as of December 31, 2015 is 6.07% and 5.01%, respectively.

Millions of euros		
2015	BBVA	la Caixa
Financial expenses	7	1
Receipt of services	4	3
Total expenses	**11**	**4**
Financial revenues	1	1
Dividends received (1)	16	–
Total revenues	**17**	**1**
Financing transactions	54	49
Guarantees granted	68	8
Time deposits	421	412
Dividends distributed (2)	212	113

(1) As of December 31, 2015 Telefónica holds 0.69% investment in BBVA (See Note 9.3.).
(2)Additionaly to the amount included in this line, it should be considered the shares received by La Caixa, in relation with the scrip dividend paid on December 2015.

Millions of euros		
2014	BBVA	la Caixa
Financial expenses	8	2
Receipt of services	4	3
Total expenses	**12**	**5**
Financial revenues	4	19
Dividends received	14	–
Total revenues	**18**	**19**
Financing transactions	1,107	1,173
Guarantees granted	68	8
Time deposits	302	21

Dividends distributed	194	98

In addition, the nominal outstanding value of derivatives held with BBVA and la Caixa in 2015 amounted to 18,483 and 1,241 million euros, respectively (23,233 million euros held with BBVA and 1,221 million euros held with la Caixa in 2014). The fair value of these same derivatives in the balance sheet is 805 and -26 million euros, respectively, in 2015 (642 and -36 million euros, respectively, in 2014). As explained in Derivatives policy in Note 16, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying.

Group companies and Associates

Telefónica, S.A. is a holding company for various investments in companies in Latin, Spain and the rest of Europe which do business in the telecommunications, media and entertainment sectors.

The balances and transactions between the Company and these subsidiaries (Group and Associated Companies) at December 31, 2015 and 2014 are detailed in the notes to these individual financial statements.

Directors and senior executives

During the financial year to which these accompanying financial statements refer, the Directors and senior executives did not perform any transactions with Telefónica, S.A. or any Telefónica Group company other than those in the Group's normal trading activity and business.

Compensation and other benefits paid to members of the Board of Directors and senior executives are detailed in Note 21.f and Appendix II of these financial statements.

A member of Telefónica, S.A.'s Board of Directors is also board member of Abertis Infraestructuras, S.A., parent of Abertis. Telefónica has signed agreements with Abertis, through its subsidiary On Tower Telecom Infraestructuras S.A. (previously Abertis Tower, S.A.), by virtue of which Telefónica Spain has sold mobile phone towers for 44 and 224 million euros in 2015 and 2014, respectively, generating a gain of 38 million euros in 2015 and a gain of 193 million euros in 2014.

An agreement has also been signed through which On Tower Telecom Infraestructuras, S.A. leases certain space in the aforesaid infrastructures for Telefónica Móviles España, S.A.U. to install its communications equipment.

f) Auditors' fees

The fees accrued in 2015 and 2014 to the various member firms of the EY international organization (previously Ernst & Young), to which Ernst&Young, S.L. (the auditors of Telefónica, S.A. in 2015 and 2014) belongs, amounted to 3.73 million euros and 3.6 million euros, respectively, broken down as follows.

Millions of euros	2015	2014
Audit services	3.52	3.38
Audit-related services	0.21	0.22
Total	**3.73**	**3.60**

EY has not provided the Company with tax advice or other services except as disclosed above.

g) Environmental matters

Telefónica has an Environmental Policy which is applicable to all of its companies, which sets out the road map for the company to advance towards a green economy, reducing the environmental impact of its facilities at the same time as developing the potential for digital services to reduce the environmental footprint of other sectors.

Currently over half of the companies in the Group have Environmental Management Systems (EMS) in accordance with Regulation ISO 14001, certified by an external body, which contribute to the proper management of the environmental aspects of the company and to extending a culture of environmental responsibility across the whole supply chain.

Telefónica's environmental risks and climate change are controlled and managed under the company's global risk model. The environmental aspects of the telecommunications operations are mainly focused on the risk of high geographical dispersion and energy consumption, which is controlled by means of environmental management based on uniform processes and a global energy efficiency programme.

Telefónica has a global environmental team made up of experts in environmental management.

h) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued (see Note 20 a.).

Note 21. Cash flow analysis

Cash flows from/(used in) operating activities

The net result before tax in 2015 amounted to negative 1,496 million euros (see the income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year.

These adjustments relate mainly to:

- Impairments to investments in Group companies, associates and other investments of 4,457 million euros (impairment in 2014 of 1,179 million euros).
- Declared dividends as income in 2015 for 5,171 million euros (6,670 million euros in 2014), interest accrued on loans granted to subsidiaries of 162 million euros (107 million euros in 2014) and a net financial expense of 1,906 million euros (2,542 million euros in 2014), adjusted initially to include only movements related to cash inflows or outflows during the year under "Other cash flows from operating activities."

"Other cash flows from operating activities" amounted to 2,410 million euros (8,222 million euros in 2014). The main items included are:

a) Net interest paid:

Payments of net interest and other financial expenses amounted to 1,831 million euros (1,872 million euros in 2014), including:

- Net payments external credit entities of 336 million euros (net proceeds of 10 million euros in 2014), and
- Interest and hedges paid to Group companies of 1,812 million euros (1,862 million euros in 2014). The main payments in 2015 were to Telefónica Emisiones, S.A.U., for 1,619 million euros, and to Telefónica Europe, B.V., for 453 million euros.

b) Dividends received:

The main receipts relate to:

Millions of euros	2015	2014
Telefónica de España, S.A.U.	1,601	1,999
Telefónica Móviles España, S.A.U.	718	994
Telefónica Europe, plc. (Note 22)	-	1,304
Telefónica Czech Republic, a.s.	250	-
Telefónica Internacional, S.A.U.	-	4,500
Compañía de Inversiones y Teleservicios, S.A.U.	-	440
Telefônica Brasil, S.A. (Telesp)	252	199
Sao Paulo Telecommunicaçoes	83	54
Other dividend collections	187	260
Total	**3,091**	**9,750**

In addition to the dividends recognized as income in 2015 (see Note 19.1) and collected in the same period, this caption also includes dividends from 2014 collected in 2015.

c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. Payments of totaling 47 million euros were made in 2015 (270 million in 2014), as disclosed in Note 17. In this regard, the main amounts passed on to subsidiaries of the tax group were as follows:

Telefónica Móviles España, S.A.U.: collection of 344 million euros, corresponding to: 288 million euros for the 2014 income tax settlement and 56 million in payments of account of 2015 income tax.

In 2014, rebilling amounted to 156 million euros, corresponding mainly to: 35 million euros for the 2013 income tax settlement, 59 million euros in payments of account of 2014 income tax and 62 million euros of the third payment of account of 2013 income tax that has been paid in 2014.

Telefónica de España, S.A.U.: collection of 616 million euros, corresponding to: 506 million euros for the 2014 income tax settlement and 110 million in payments of account of 2015 income tax.

In 2014, rebilling amounted to 322 million euros, corresponding mainly to: 66 million euros for the 2013 income tax settlement, 140 million in payments of account of 2014 income tax and 116 million euros of the third payment of account of 2013 income tax that has been paid in 2014.

Cash flows from/(used in) investing activities

"Payments on investments" under "Cash flows from/(used in) investing activities" included a total payment of 4,915 million euros (5,704 million euros in 2014). The main transactions to which these payments refer are as follows:

- Capital increases: the main disbursements correspond to Telefónica Internacional, S.A.U. amounting 2,157 million euros, Telefônica Brasil, S.A. amounting 1,263 million euros and Sao Paulo Telecomunicaçoes amounting 402 million euros. These capital increases, as well as other minor disbursements of this same concept are disclosed fully in Note 8.1.a).
- In 2015 there has been no significant disboursements related to loan to Group and associated companies.

Proceeds from disposals totaling 2,067 million euros in 2015 (2,680 million euros in 2014) includes:

- Proceed from the repayment of the loans granted to Telco, S.p.A. later repaid by Telco TE, S.p.A. (see Note 9) amounting to 1,025 million euros.
- The proceeds from the maturity of debentures and bonds issued by Telefónica Emisiones, S.A.U. amounting to 145 million euros.
- Proceed from the pay back of the share premium disbursed by Phenix Investments (see Note 8).

Cash flows from/(used in) financing activities

This caption includes the following items:

i. Net payments for equity instruments of 1,615 million euros (21 million euros in 2014), relating to the net amount of treasury shares acquired in 2015.

ii. Proceeds from financial liabilities:

a) Debt issues: The main collections comprising this heading are as follows:

Millions of euros	2015	2014
Issue exchangeable into ordinary shares of Telecom Italia, S.p.A.	-	750
Syndicated facilities with several entities (Note 14.4)	3,950	-
Bilateral loans with several entities (Note 14.4)	475	2,125
Telefónica Emisiones, S.A.U. (Note 15)	1,467	2,918
Telefónica Europe, B.V. promissory notes (Note 15)	935	2,600
Telfisa Global, B.V. financing (Note 15)	-	580
Structured Financing	506	565
Promissory notes (Note 13)	61	-

Credit lines with several entities (Note 14)	826	-
Other collections	245	500
Total	**8,465**	**10,038**

b) Prepayments and redemption of debt: The main payments comprising this heading are as follows:

Millions of euros	2015	2014
Bond redemption (Note 13)	50	582
Bilateral loans with several entities (Note 14.4)	500	200
Syndicated facilities with several entities (Note 14.4)	3,778	4,595
Telefónica Europe, B.V. (Note 15)	1,073	929
Telfisa Global, B.V.	2,048	-
Telefónica Finanzas, S.A.U.	534	1,799
Telefónica Emisiones, S.A.U. (Note 15)	3,292	4,059
Telefónica Europe, B.V. promissory notes	-	423
Promissory notes	-	355
Structured Financing	245	206
Other payments	172	392
Total	**11,692**	**13,540**

The commercial paper transactions with Telefónica Europe, B.V. are stated at their net balance as recognized for the purposes of the cash flow statement, being high-turnover transactions where the interval between purchase and maturity never exceeds six months.

The financing obtained by the Company from Telefónica Finanzas, S.A.U. and Telfisa Global, B.V. relates to the Group's integrated cash management (see Note 15). These amounts are stated net in the cash flow statement as new issues or redemptions on the basis of whether or not at year-end they represent current investment of surplus cash or financed balances payable.

iii. Payments of dividends for 2,237 million euros (2,001 million euros in 2014) as described in Note 11.1. d). The difference between the figure of Dividends shown in this Note and in Note 11 is caused by withholding taxes deducted in the payment to certain major shareholders, and despite the reimbursement of the amounts has been requested to Tax Authorities, the cash has not been received until 2016.

iv. Proceeds on the share capital increase amount to 3,048 million euros described in Note 11, presented net of all the expenses related to the transaction in the statement of changes in equity.

Note 22. Discontinued operations

As detailed in Note 8, Telefónica, S.A. has signed an agreement with Hutchison for the acquisition by the latter of Telefónica's operations in the UK. As a consequence of this agreement, the *fair value* of the investment and the valuation write off in Telefónica Europe, plc. has been reclassified under "Net assets held for sale. As of December 31, 2015 this concept amounts to 12,501 million euros.

The write down in 2015, net of tax effects, has been recognized under "Profit after tax from discontinued operations". In order to ensure the comparison of information, this concept has been classified in the same caption in the income statement for 2014 (see Note 2).

In addition to the investment write off, every transaction between Telefónica, S.A. and its subsidiaries in the UK, net of the tax effect, has been reclassified to discontinuated operation in 2015 profit and loss account.

The disclosure of concepts and amounts reclassified is the following:

(Millions of euros)	2015
Services rendered to Group companies	35
Other operating income Group companies	1
Impairment losses in Group companies and associates	(852)
External services Group companies	(3)
Financial revenue Group companies	1
Exchange rate differences, net	3
Income Tax	217
Discontinued operations, net of tax	(598)

The write down recognized for Telefónica Europe, plc. in 2015 amounts to 688 million euros includes the impact of net investment hedges. In 2014 the write down amounted to 2,352 million euros, increased by 148 million euros for the effect of the net investment hedge.

The valuation of Telefónica Europe, plc. in 2015 has been effected by a lower increase in the GDP than expected: 2.2% of increase according to Focus Economics, previewing an increase of 2.6% and speeding off since the increase of 2.9% for 2014.

The amounts related to transactions with subsidiaries in UK within the Cash Flow Statements are detailed below:

- Cash flows from operating activities include net proceeds of 37 million euros in 2015 (1,333 millions in 2014). The most significant concepts are brand fee proceeds of 42 million in 2015 (38 million in 2014). Moreover, in 2014 there was a proceed from dividends of 1,304 million euros (no amounts in 2015).
- Cash flows from financing activities include net proceeds of 11 million euros in 2015 (5 million euros in 2014)
- Cash flows from investment activities include in 2015 a net proceed from divestments of 19 million euros arising from hedges of the sale transaction.

Note 23. Events after the reporting period

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

Financing

On February 2, 2016, Telefónica Emisiones, S.A.U. redeemed 1,750 million euros of its notes, issued on February 2, 2006. The notes were guaranteed by Telefónica, S.A.

On February 3, 2016, Telefónica Emisiones, S.A.U. redeemed 802 million euros of its notes, issued on November 3, 2011 for an amount of 1,000 million euros. The notes were guaranteed by Telefónica, S.A.

On February 16, 2016, Telefónica Emisiones, S.A.U. redeemed 1,250 million U.S. dollars of its notes, issued on February 16, 2011. The notes were guaranteed by Telefónica, S.A.

Telefónica, S.A. agreed its 12 months extension option on the 2,500 million euros syndicated credit facility dated February 19, 2015 up to 2021 and on the 3,000 million euros syndicated credit facility dated February 18, 2014 up to 2020. This arrangement entered into effect on February 19, 2016.

Creation of a global telecommunications infrastructures company

On February 10, 2016, Telefónica announced the creation of Telxius, a company which will bring together certain infrastructure assets of the Group, which will enable the management of the Telefónica Group's infrastructure on a global scale with a more specialised and focused approach, with the aim of increasing the services provided to other operators, improving the return on capital invested and allowing Telxius to participate more actively in the growth opportunities that exist in the industry, including the possibility of incorporating third party assets.

Note 24. Additional note for English translation

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company's Directors in the meeting held on February 24, 2016. In the event of a discrepancy, the Spanish-language version prevails.

Appendix I: Details of subsidiaries and associates at December 31, 2015

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica Internacional, S.A.U. (SPAIN) Holding company Gran Vía, 28 - 28013 Madrid	100.00%	-	2,839	4,204	1,000	(2.230)	(1,710)	9123
Telefónica Móviles España, S.A.U. (SPAIN) Wireless communications services provider Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	-	423	499	718	553	373	5,775
Telfin Ireland Limited (IRELAND) Intragroup financing 28/29 Sir John Rogerson's Quay, Dublin 2	100.00%	-	-	8,011	705	(1)	194	8,191
O2 (Europe) Ltd. (UNITED KINGDOM) Holding company Wellington Street, Slough, SL1 1YP	76.83%	-	1,239	4,890	-	(161)	(42)	2,764
Telefónica Móviles México, S.A. de C.V. (MEXICO) (1) Holding company Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, México D.F. CP.05349	100.00%	-	4,478	(3,185)	-	112	(90)	1,540
Telefónica de España, S.A.U. (SPAIN) Telecommunications service provider in Spain Gran Vía, 28 - 28013 Madrid	100.00%	-	1,024	1,520	1,601	(425)	(422)	2,303
Telefónica de Contenidos , S.A.U. (SPAIN) Organization and operation of multimedia service-related activities and businesses Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	-	226	451	-	(47)	(43)	616
Telefónica Datacorp, S.A.U. (SPAIN) Holding company Gran Via, 28 - 28013 Madrid	100.00%	-	700	61	-	20	20	781
Telfisa Global, B.V. (NETHERLANDS) Integrated cash management, consulting and financial support for Group companies Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX - Amsterdam	100.00%	-	-	701	37	(4)	18	712
Ecuador Cellular Holdings, B.V. (NETHERLANDS) Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%,	-	-	595	-	(11)	(11)	581
Telefónica Chile Holdings , S.L (SPAIN) Holding company Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	-	-	1,209	-	-	-	473
Telefónica Innovación Alpha, S.L. (SPAIN) Telecommunications activities Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	-	-	-	-	-	-	-
Telco TE, S.p.A. (ITALY) Holding company Via dell'Annunciata n.21 20121 – Milano	100.00%	-	-	603	-	-	43	603
Panamá Cellular Holdings, B.V. (NETHERLANDS) Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%	-	-	1	-	-	-	1

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Teléfonica de Costa Rica TC, S.A. (COSTA RICA) Holding company Plaza Roble, Edificio Los Balcones 4to. Piso, San José	100.00%	-	296	(128)	-	(19)	(21)	286
Telefónica Global Technology, S.A. (SPAIN) Global management and operation of IT systems Gran Vía, 28 - 28013 Madrid	100.00%	-	16	99	-	8	37	148
Telefónica Capital, S.A. (SPAIN) Finance company Gran Via, 28 - 28013 Madrid	100.00%	-	7	138	-	-	5	110
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) Life insurance, pensions and health insurance Ronda de la Comunicación, s/n Distrito Telefónica Edificio Oeste 1, planta 9- 28050 Madrid	100.00%	-	51	57	5	2	7	69
Telefónica Digital Holdings, S.L. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica Edificio Central - 28050 Madrid	100.00%	-	10	338	-	(246)	(247)	89
Taetel, S.L. (SPAIN) Acquisition, ownership and disposal of shares and stakes in other companies Gran Via, 28 - 28013 Madrid	100.00%	-	28	42	94	(1)	(1)	69
Telefónica Internacional USA Inc.(EE.UU.) Financial Advisoryservices 1221 Brickell Avenue suite 600 - 33131 Miami – Florida	100.00%	-	-	1	-	-	-	-
Lotca Servicios Integrales, S.L. (SPAIN) Holding and operation of aircraft and aircraft leases Gran Via, 28 - 28013 Madrid	100.00%	-	17	(7)	-	-	(1)	9
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) Security services and systems Ramón Gómez de la Serna, 109-113 posterior - 28035 Madrid	100.00%	-	12	(15)	-	(9)	(14)	-
Compañía Española de Tecnología, S.A. (SPAIN) Promotion of business initiatives and holding of real estate assets Gran Vía, 28 - 28013 Madrid	100.00%	-	5	4	-	-	-	9
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN) Integrated cash management, consulting and financial support for Group companies Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	-	3	(14)	98	(3)	22	11
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) Design of communications products Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid	100.00%	-	-	-	-	-	-	-
Telefónica International Wholesale Services II, S.L. (SPAIN) Telecommunications service provider and operator Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	-	-	(130)	-	(49)	(36)	-
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN) Telecommunications research activities and projects Telecomunications Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	-	6	27	-	(30)	(23)	6

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefonica Luxembourg Holding S.à.r.L. (LUXEMBOURG) Holding company 26, rue Louvingny, L-1946- Luxembourg	100.00%	-	3	76	-	-	-	4
Telefónica Servicios Globales, S.L.U. (SPAIN) Management and administrative services rendered Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	-	1	14	-	(2)	(2)	1 4
Fisatel Mexico, S.A. de C.V. (MEXICO) Integrated cash management, consulting and financial support for Group companies Boulevard Manuel Avila Camacho, 24 - 16ª Plta. - Lomas de Chapultepec - 11000 Mexico D.F.	100.00%	-	195	(1)	-	-	7	196
Terra Networks Marocs S.A.R.L. Dormant Company 332 Boulevard Brahim Roudani, Casablanca	100.00%	-	-	-	-	-	-	-
Telefónica Participaciones, S.A (SPAIN) Integrated cash management, consulting and financial support for Group Companies Gran Via, 28 - 28013 Madrid	100.00%	-	-	1	-	-	-	-
Telefónica Emisiones, S.A.. (SPAIN) Integrated cash management, consulting and financial support for Group Companies Gran Via, 28 - 28013 Madrid	100.00%	-	-	6	-	(2)	2	-
Telefónica Europe, B.V. (NETHERLANDS) Fund raising in capital markets Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX – Amsterdam	100.00%	-	-	5	1	(1)	1	-
Telefónica Consumer Finance E.F.C.,S.A. (SPAIN.) Lending and consumer loans c/Caleruega, 102 -28033 Madrid	50.00%	-	5	22	-	5	2	14
Telefónica Latinoamérica Holding, S.L. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica - 28050 Madrid	94.96%	5.04%	198	1,694	341	-	22	1,762
Telefónica International Wholesale Services, S.L. (SPAIN) International services provider Ronda de la Comunicación, s/n Distrito Telefónica - 28050 Madrid	92.51%	7.49%	230	68	19	191	142	213
Corporation Real Time Team, S.L. (SPAIN) Internet design, advertising and consulting Plaza Canalejas, 3 – 28014 Madrid	87.96%	12.04%	-	-	-	-	-	-
Telefónica Móviles Argentina Holding, S.A. (ARGENTINA) Holding company Ing Enrique Butty 240, piso 20-Capital Federal-Argentina	75.00%	25.00%	300	513	-	505	235	885

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica International Wholesale Services America, S.A. (URUGUAY) (1) Provision of high bandwidth communications services Luis A. de Herrera, 1248 Piso 4 – Montevideo	74.36%	25.64%	562	(537)	-	(29)	(29)	325
Telefonica Centroamérica Inversiones, S.L (SPAIN) Holding company Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	60.00%	-	1	952	42	-	55	655
Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) Holding company Torre Edicampo, Avda. Francisco de Miranda, Caracas 1010	65,14%	34,86%	-	(130)	-	(49)	(36)	-
Telefónica América, S.A (SPAIN). Investment managament and gestion of companies in the telecomunications sector Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	50.00%	50.00%	-	-	-	-	-	-
Aliança Atlântica Holding B.V. (NETHERLANDS) Portfolio company Strawinskylaan 1725 – 1077 XX – Amsterdan	50.00%	43.99%	40	2	-	-	-	21
Sao Paulo Telecomunicaciones Participaçoes, Ltda (BRAZIL) Holding company Rua Martiniano de Caravalho, 851 20º andar, parte, Sao Paolo	39.40%	60.60%	5,346	(1,394)	85	(8)	208	1,605
Telefônica Brasil, S.A. (BRAZIL) (1)(*) Wireline telephony operator in Sao Paulo Sao Paulo	29.77%	43.91%	23,164	(6,805)	371	1,568	1,070	7,437
Colombia Telecomunicaciones, S.A. ESP (COLOMBIA) (1) Wireless operator Calle 100, Nº 7-33, Piso 15, Bogotá,Colombia	18.51%	51.49%	485	(537)	-	204	(26)	265
Pléyade Peninsular, Correduría de Seguros y Reaseguros del grupo Telefónica, S.A. (SPAIN) Distribution, promotion or preparation of insurance contracts,operating as a broker Distrito Telefónica, Avda. Ronda de la Comunicación, s/n Edificio Oeste 1 – 28050 Madrid	16.67%	83.33%	-	1	1	4	4	-
Telefónica Móviles Argentina, S.A. (SPAIN) (2) Wireless communications and services operator Ing Enrique Butty 240, piso 20-Capital Federal-Argentina	15.40%	84.60%	N/D	N/D	N/D	N/D	N/D	146
Inversiones Telefónica Móviles Holding, Ltd. (CHILE) Holding company Miraflores, 130 - 12º - Santiago de Chile	1.73%	98.27%	971	285	-	-	80	89

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica de Argentina, S.A. (1) (ARGENTINA) Telecommunications service provider Av. Ingeniero Huergo, 723, PB - Buenos Aires	1.80%	98.20%	191	161	-	103	41	18
Telefónica Venezolana, C.A. (VENEZUELA) (1) Wireless operator Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060	0.08%	99.92%	658	(302)	-	(44)	(207)	-
Telefónica Factoring España, S.A. (SPAIN) Factoring Zurbano, 76, 8 Plta. - 28010 Madrid	50.00%	-	5	2	-	19	16	3
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) Factoring México D.F.	40.50%	9.50%	2	-	-	(1)	1	1
Telefónica Factoring Perú, S.A.C. (PERÚ) Factoring Ciudad de Lima	40.50%	9.50%	1	2	-	-	2	1
Telefónica Factoring Colombia, S.A. (COLOMBIA) Factoring Bogotá	40.50%	9.50%	1	-	-	2	1	1
Telefónica Factoring Chile, S.A. (CHILE) Factoring Ciudad y Comuna de Santiago.	40.50%	9.50%	-	-	-	1	1	-
Telefónica Factoring Do Brasil, Ltd. (BRASIL) Factoring Avda. Paulista, 1106 – Sao Paulo	40.00%	10.00%	1	(2)	-	(1)	8	1
Jubii Europe N.V. (NETHERLANDS) (*) Internet portal - In liquidation Richard Holkade 36, 2033 PZ Haarlem – PAISES BAJOS	32.10%	-	N/D	N/D	-	N/D	N/D	5
Torre de Collçerola, S.A. (SPAIN) Operation of telecommunicatios mast and technical assistance and consulting services. Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona	30.40%	-	6	-	-	-	-	2
Other investments	N/D	N/D	N/D	N/D	47	N/D	-	5
Total group companies and associates					**5,171**			**47,938**

(1) Consolidated data.
(2) Data included in Telefónica Móviles Argentina Holding as consolidated figures.
(*)Companies listed on international stock exchanges at December 31, 2015.

Appendix II: Board of Director's and Senior Executives' Compensation

TELEFÓNICA, S.A.

(Euros)

Director	Wage / Compen-sation[1]	Fixed payment[2]	Attendance fees[3]	Short term variable compen-sation[4]	Fixed payments Board Committees[5]	Other items[6]	Total
Mr. César Alierta Izuel	2,230,800	240,000	-	4,027,486	80,000	15,430	6,593,716
Mr. Isidro Fainé Casas	-	200,000	-	-	80,000	10,000	290,000
Mr. José María Abril Pérez	-	200,000	4,000	-	91,200	-	295,200
Mr. Julio Linares López	-	200,000	31,000	-	44,800	-	275,800
Mr. José María Alvarez-Pallete López	1,923,100	-	-	3,471,965	-	5,795	5,400,860
Mr. Fernando de Almansa Moreno-Barreda	-	120,000	19,000	-	33,600	9,000	181,600
Ms. Eva Castillo Sanz[8]	-	110,000	16,000	-	30,800	-	156,800
Mr. Carlos Colomer Casellas	-	120,000	30,000	-	147,200	10,000	307,200
Mr. Peter Erskine	-	120,000	24,000	-	124,800	-	268,800
Mr. Santiago Fernández Valbuena	-	-	-	-	-	-	-
Mr. Alfonso Ferrari Herrero	-	120,000	46,000	-	158,400	9,000	333,400
Mr. Luiz Fernando Furlán	-	120,000	-	-	-	-	120,000
Mr. Gonzalo Hinojosa Fernández de Angulo	-	120,000	46,000	-	158,400	9,000	333,400
Mr. Pablo Isla Álvarez de Tejera	-	120,000	-	-	11,200	-	131,200
Mr. Antonio Massanell Lavilla	-	120,000	21,000	-	56,000	11,000	208,000
Mr. Ignacio Moreno Martínez	-	120,000	17,000	-	33,600	-	170,600
Mr. Javier de Paz Mancho	-	120,000	14,000	-	113,600	5,333	252,933
Mr. Wang Xiaochu[7]	-	30,000	-	-	-	-	30,000

1 Wage: Non-variable compensation accrued by the Director for discharging executive duties.

2 Fixed Payment: Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Board of Directors, irrespective of effective attendance by the Director at Board Meetings.

3 Attendance fees: Amounts payable for attendance to meetings of the Advisory or Control Committees.

4 Short-term variable compensation (bonus): Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) for a period equal to or up to a year, corresponding to 2014 and paid in 2015. Concerning the bonus referred to 2015, to be paid during 2016, the Executive Directors will perceive the following amounts: Mr. César Alierta Izuel 4,015,440 euros and Mr. José María Álvarez-Pallete López 3,461,580 euros.

5 Fixed Payment Board Committees: Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Executive Committee or Advisory or Control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.

6 Other items: Includes, inter alia, amounts paid for membership of the Regional Advisory Committees in Spain (Valencia, Andalusia and Catalonia) and other "in- kind compensation" (such as general medical insurance and dental coverage), paid by Telefónica, S.A.

7. Mr. Wang Xiaochu was appointed member of the Board of Directors of Telefónica, S.A, replacing Mr. Chang Xiaobing, on September 31, 2015, date from which he perceives his remuneration. Mr. Chang Xiaobing received 90,000 euros as wage/compensation until that moment.

8. On February 26, 2014, Ms. Eva Castillo Sanz ceased to hold office as Chair of Telefónica Europe, although she continued to fulfill duties at the Telefónica Group other than those inherent in her capacity as Director through December 31, 2014. After that date, Ms. Eva Castillo Sanz stopped performing any duties other than those inherent in her capacity as Director, and received 2,405,000 euros in January 2015 as compensation for the aforementioned termination, and the sum of 862,475 euros in settlement of her participation in the "Performance & Investment Plan" (equal to the value of the Telefónica, S.A. shares to which she was entitled for participating in such plan), for the two cycles covering 2012-2015 and 2013-2016.Likewise, Ms. Castillo perceived a variable compensation, corresponding to 2014, of 1,200,000 euros.

In addition, to detail the amounts included in the preceding table, the following table presents the specific compensation paid to Directors of Telefónica for membership of the various Advisory or Control Committees in 2015, including both fixed payments and fees for attending meetings:

TELEFÓNICA, S.A. ADVISORY OR CONTROL COMMITEES

(Euros)

Director	Audit and Control	Nomination, Compensation and Corporate Governance	Regulation	Service Quality and Customer Service	Innovation	Strategy	Institu-tional Affairs	TOTAL 2015
Mr. César Alierta Izuel	-	-	-	-	-	-	-	-
Mr. Isidro Fainé Casas	-	-	-	-	-	-	-	-
Mr. José María Abril Pérez	-	-	-	-	15,200	-	-	15,200
Mr. Julio Linares López	-	-	-	-	21,200	21,200	33,400	75,800
Mr. José María Álvarez-Pallete López	-	-	-	-	-	-	-	-
Mr. José Fernando de Almansa Moreno-Barreda	-	-	15,200	-	-	18,200	19,200	52,600
Ms. Eva Castillo Sanz	-	-	14,267	13,267	-	19,267	-	46,801
1Mr. Carlos Colomer Casellas	33,400	17,200	-	13,200	33,400	-	-	97,200
Mr. Peter Erskine	-	18,200	-	-	18,200	32,400	-	68,800
Mr. Santiago Fernández Valbuena	-	-	-	-	-	-	-	-
Mr. Alfonso Ferrari Herrero	20,200	32,400	16,200	14,200	-	22,200	19,200	124,400
Mr. Luiz Fernando Furlán	-	-	-	-	-	-	-	-
Mr. Gonzalo Hinojosa Fernández de Angulo	21,200	21,200	27,400	14,200	-	21,200	19,200	124,400
Mr. Pablo Isla Álvarez de Tejera	-	11,200	-	-	-	-	-	11,200
Mr. Antonio Massanell Lavilla	20,200	-	-	26,400	13,200	-	17,200	77,000
Mr. Ignacio Moreno Martínez	22,200	-	15,200	13,200	-	-	-	50,600
Mr. Francisco Javier de Paz Mancho	-	-	14,200	13,200	-	-	20,200	47,600
Mr. Wang Xiaochu	-	-	-	-	-	-	-	-

On the other hand, the following table presents an individual breakdown of the amounts received from Telefónica Group companies other than Telefónica, S.A., by Company's Directors for discharging executive duties or for membership of the companies' governing bodies and/or Advisory Boards of such companies:

OTHER TELEFÓNICA GROUP COMPANIES

(Euros)

Director	Wage / Compen-sation[1]	Fixed payment[2]	Attendance fees[3]	Short term variable compen-sation[4]	Fixed payments Board Committees[5]	Other items[6]	Total
Mr. César Alierta Izuel	-	-	-	-	-	-	-
Mr. Isidro Fainé Casas	-	-	-	-	-	-	-
Mr. José María Abril Pérez	-	-	-	-	-	-	-
Mr. Julio Linares López	-	-	-	-	-	240,000	240,000
Mr. José María Álvarez-Pallete López	-	-	-	-	-	-	-
Mr. José Fernando de Almansa Moreno-Barreda	-	138,904	-	-	-	120,000	258,904
Ms. Eva Castillo Sanz	-	-	-	-	-	60,000	60,000
Mr. Carlos Colomer Casellas	-	-	-	-	-	-	-
Mr. Peter Erskine	-	-	-	-	-	-	-
Mr. Santiago Fernández Valbuena (*)	1,007,668	-	-	1,212,857	-	196,632	2,417,157
Mr. Alfonso Ferrari Herrero	-	75,927	-	-	-	120,000	195,927
Mr. Luiz Fernando Furlán	-	86,544	-	-	-	90,000	176,544
Mr. Gonzalo Hinojosa Fernández de Angulo	-	26,187	-	-	-	120,000	146,187
Mr. Pablo Isla Álvarez de Tejera	-	-	-	-	-	-	-
Mr. Antonio Massanell Lavilla	-	-	-	-	-	-	-
Mr. Ignacio Moreno Martínez	-	-	-	-	-	-	-
Mr. Francisco Javier de Paz Mancho	-	127,123	-	-	-	120,000	247,123
Mr. Wang Xiaochu	-	-	-	-	-	-	-

1 Wage: Non-variable compensation accrued by the Director for discharging executive duties of any Telefónica Group company.

2 Fixed Payment: Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Board of Directors, irrespective of affective attendance by the Director at Board Meetings of any Telefónica Group company.

It is hereby stated that Ms. Eva Castillo has earned an amount of 60,000 euros in fiscal year 2015, derived from her performace at Supervisory Board of Telefónica Deutschland Holding, A.G. At the time of preparing this document, the amount has not been paid.

3 Attendance fees: Amounts payable for attendance to meetings of the Board of Directors or similar bodies of any Telefónica Group company.

4 Short-term variable compensation (bonus): Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) for a period equal to or up to a year, corresponding to 2014 and paid in 2015. Concerning the bonus referred to 2015, the amount that will be perceived by the Executive Director Mr. Santiago Fernández Valbuena is 1,209,203 euros.

5 Fixed Payment Board Committees: Cash compensation with a predefined payment frequency, accruable or not over time and accrued by the Director for membership to the Executive Committee or Advisory or Control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.

6 Other items: Includes, inter alia, amounts paid for membership of Regional and Business Advisory Committees (Spain y Latam) and other "in- kind compensation" (such as general medical insurance and dental coverage and vehicle), paid by any Telefónica Group Company.

(*) It is hereby stated for the record that Executive Director Mr. Santiago Fernández Valbuena collects his remuneration in Brazilian reais, and accordingly, the stated amount of his remuneration may vary, depending on the exchange rate applicable at any particular time.

Furthermore, as explained in the Compensation policy section, Executive Directors receive a series of employee benefits. The following table presents a breakdown of contributions made in 2015 by the Company to long-term savings schemes (Pension Plans and Pension Plan for Senior Executives):

LONG-TERM SAVINGS SCHEMES

(Euros)

Director	2015 Contributions
Mr. César Alierta Izuel	100,609
Mr. José María Álvarez-Pallete López	673,085
Mr. Santiago Fernández Valbuena	485,302

The following table presents a breakdown of the long-term savings schemes, comprising contributions to Pension Plans, the Pension Plan and Unit link insurance:

(Euros)

Director	Contributions to Pension Plans	Contributions to Benefits Plan[1]	Contributions to Unit link - Pension Plan
Mr. César Alierta Izuel	5,377	-	95,232
Mr. José María Álvarez-Pallete López	6,060	540,968	126,057
Mr. Santiago Fernández Valbuena	99,908	385,394	-

1 Contributions to the Pension Plan for Executives set up in 2006, funded exclusively by the Company to complement the existing Pension Plan. It entails defined contributions equivalent to a certain percentage of the Director´s fixed remuneration in accordance with their professional category within the Telefónica Group´s organization. Furthermore, since February 2015 the Chairman is the beneficiary of a Benefits Plan managed by Banco Sabadell ("BS Plan Jubilación Colectivo") the receipt of which would take place in the circumstances set out in the PPSD.

It is hereby stated for the record that financial and fiscal limits to the contributions to the Pensions Plans have been lowered in 2015 by the applicable law, so it has been contracted a Unit link collective insurance, in which all surpluses derived for the application of the alleged limits over the contributions to Pension Plans are applied.

The Unit link insurance, contracted with the insurance company Seguros de Vida y Pensiones Antares, S.A, covers the same contingencies as the "Pension Plans" and the same cases of exceptional liquidity in event of severe illness or long-term unemployment.

Life insurance premiums paid in 2015 are as follows:

LIFE INSURANCE PREMIUMS

(Euros)

Director	Life insurance premiums
Mr. César Alierta Izuel	74,271
Mr. José María Álvarez-Pallete López	15,286
Mr. Santiago Fernández Valbuena	6,887

Regarding share-based payment plans (those exclusively for Executive Directors), there were two long-term variable compensation plans in place in 2015:

1.- The first Plan is the so-called "Performance & Investment Plan" ("PIP"), approved at the General Shareholders' Meeting of May 18, 2011 whose first phase began in 2011 and ended in July 2014, second phase began in 2012 and ended in July 2015, and third phase began in 2013 and will end in July 2016.

It is hereby stated that, regarding the second phase of this Plan (2012-2015) implemented in 2015, in accordance with the TSR target achieved by the shares of Telefónica, S.A. in comparison to the TSR target achieved by the companies integrating the "DJ Sector Titans Telecoms index", the applicable coefficient to shares assigned to beneficiaries was 77%.

The number of shares to be perceived by the Directors of Telefónica for discharging executive duties in second phase (2012–2015) is as follows:

FIRST PIP- Second phase / 2012-2015

Directors	Number of theoretical shares assigned (without co-investment)	Maximum number of shares assigned (1)	Number of shares delivered in the second phase (2)
Mr. César Alierta Izuel	324,417	506,901	312,251
Mr. José María Álvarez-Pallete López	188,131	293,955	181,076
Mr. Santiago Fernández Valbuena	103,223	161,287	99,352
Mr. Julio Linares López(*)	13,878	21,686	13,358

(*) The number of shares assigned to Mr. Linares was calculated in proportion to the time he discharged executive duties as Chief Operating Officer – COO- (from July 1, 2012 to September 17, 2012) during the second phase of the Plan.

(1) Maximum number of shares assigned if the co-investment requirement and maximum target TRS are met

(2) Number of shares effectively delivered after application of the corresponding coefficient (77%) for meeting TSR target.

The number of shares assigned (without co-investment) to the Directors of Telefónica for discharging executive duties in third phase (2013 – 2016), and the maximum number of shares assigned, if "co-investment" requirement set by the alleged Plan and TSR target established for each phase are met, is as follows:

FIRST PIP- Third phase / 2013-2016

Directors	Number of theoretical shares assigned (without co-investment)	Maximum number of shares assigned (*)
Mr. César Alierta Izuel	324,000	506,250
Mr. José María Álvarez-Pallete López	192,000	300,000
Mr. Santiago Fernández Valbuena	104,000	162,500

(*) Maximum number of shares assigned if the co-investment requirement and maximum target TRS are met.

2.- The second Plan, called as well “Performance & Investment Plan“ (“PIP”), approved at the General Shareholders’ Meeting of May 30, 2014 whose first phase began in 2014 and will end in October 2017, second phase began in 2015 and will end in October 2018, and third phase will begin 2016 and will end in October 2019.

It is hereby stated that the number of shares assigned (without co-investment) and the maximum number of theoretical shares assigned to the Directors of Telefónica for discharging executive duties in each phase, if the co-investment requirement established in the second Plan and the maximum target TSR are met, is as follows:

SECOND PIP- First phase / 2014-2017

Directors	Number of theoretical shares assigned (without co-investment)	Maximum number of shares (*)
Mr. César Alierta Izuel	324,000	506,250
Mr. José María Álvarez-Pallete López	192,000	300,000
Mr. Santiago Fernández Valbuena	104,000	162,500

(*) Maximum number of shares assigned if the co-investment requirement and maximum target TRS would have been met

SECOND PIP- Second phase / 2015-2018

Directors	Number of theoretical shares assigned (without co-investment)	Maximum number of shares (*)
Mr. César Alierta Izuel	324,000	506,250
Mr. José María Álvarez-Pallete López	192,000	300,000

(*) Maximum number of shares assigned if the co-investment requirement and maximum target TRS are met

3.- The second issue of the share incentive purchase plan of Telefónica, S.A. (2015-2017) addressed to all employees of the Group worldwide (including executives and Executives Directors), the "Global Employee Share Plan" ("GESP"), was approved at the Company’s General Shareholders’ Meeting of May 30, 2014.

This plan is aimed to reinforce Telefónica’s status as a global employer, with a common remuneration culture throughout the Company, to encourage all Group employees to take an equity interest, and to motivate employees and boost their loyalty.

Under this plan, employees are offered the possibility of acquiring Telefónica, S.A. shares, for a period of up to 12 months (the acquisition period), with this company assuming the obligation of giving participants a certain number of shares free of charge. The maximum sum each employee can assign to this plan is 1,800 euros, while the minimum is 300 euros. Employees who remain at the Telefónica Group and retain their shares for an additional year after the acquisition period (the consolidation period) will be entitled to receive one free share per share acquired and retained until the end of the consolidation period.

The three Executive Directors of Telefónica have decided to take part in this Plan contributing the maximum (i.e. 150 euros a month, over 12 months), and have acquired a total of 176 shares at December 31, 2015 (being entitled to freely received an equivalent number of shares, provided that the shares received have been retained during consolidation period (twelve months after finishing the purchasing period)).

It should be noted that the external Directors do not receive and did not receive in 2015 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to Telefónica’s share price (except as indicated for Mr. Linares in the above tables).

In addition, the Company does not grant and did not grant in 2015 any advances, loans or credits to the Directors, or to its top executives, thus complying with the requirements of the U.S.A. Sarbanes-Oxley Act, which is applicable to Telefónica as a listed company in that market.

Senior executives' compensation

Meanwhile, the Executives considered as Senior Executives[1] of the Company in 2015, excluding those that are also members of the Board of Directors, have received a total amount of 9,982,840 euros in 2015.

In addition, regarding to long-term savings schemes, the contributions by the Telefónica Group in 2015 with respect to the Benefits Plan for Senior Executives described in Note on "Revenue and Expenses" for these Executives amounted to 1,302,755 euros, contribution to the Pension Plan amounted to 88,400 euros and contribution to the Unit Link- Pension Plans surpluses amounted to 143,119 euros.

Furthermore, in-kind compensation (including life and other insurance premiums such us general medical and dental insurance and the vehicle) amounted to 118,762 euros.

Also, regarding the first "Performance and Investment Plan" ("PIP") composed of three phases (2011-2014; 2012-2015; 2013-2016) approved at the General Shareholders' Meeting of May 18, 2011, it is hereby stated that the second phase (2012-2015) was vested in 2015, and pursuant to the general terms of the Plan and after the application of the ratio arising from the TSR reached, 286,347 shares were effectively delivered to the Senior Executives of the top management of the Company, although the number of theoretical shares assigned (without co-investment) and the maximum number of shares assigned* was 294,136 and 456,300 respectively.

It is hereby stated that the number of shares assigned (without co-investment) at the beginning of the third phase (2013-2016) to the Executives, and the maximum number of shares assigned* is 322,520 and 500,650, respectively.

Regarding the second "Performance and Investment Plan" ("PIP") composed of three phases (2014-2017; 2015-2018; 2016-2019) approved at the General Shareholders' Meeting of May 30, 2014, the number of shares assigned (without co-investment) at the beginning of the phase to the Senior Executives of the Company in the first phase (2014-2017) and the maximum number of shares assigned* is 356,624 shares and 553,280 shares, respectively. In the second phase (2015-2018), it is equally, 356,624 shares and 553,280 shares,

Finally, regarding the "Global Employee Share Plan" ("GESP") (2015-2017), approved by the General Shareholders' Meeting of May 30, 2014, it should be noted that all the Senior Executives have decided to take part contributing the maximum (i.e. 150 euros a month, over 12 months), and have acquired a total of 315 shares (being entitled to freely received an equivalent number of shares, provided that the shares received have been keep during consolidation period (twelve months after finishing the purchasing period)).

* Maximum number of shares to be received if the co-investment requirement and maximum target TRS are met.

[1] For these purposes, Senior Executives are understood to be individuals who perform senior management functions reporting directly to the management bodies, or their executive committees or CEOs. Additionally, the person in charge of the internal audit is included.

Management report 2015

This Management Report has been prepared taking into consideration the ‘Guidelines on the preparation of annual corporate governance reports for listed companies’, published by CMNV in July 2013.

Business Model

Telefónica is one of the world’s leading communications services providers, offering mobile and fixed communication services with a strategy focused on the possibilities that the new digital world offers and becoming one of its principal leaders.

Telefónica’s aim is to reinforce its position as an active player in the digital world by seizing all the opportunities afforded by its global scale and its industrial and strategic alliances.

Telefónica’s organizational structure approved by the Board of Directors on February 26th 2014 is composed of the following segments: Telefónica Spain, Telefónica Brazil, Telefónica Germany and Telefónica Hispanoamérica (comprised of our consolidated subsidiaries in Argentina, Chile, Peru, Colombia, Mexico, Venezuela & Central America, Ecuador and Uruguay). These segments include all the information related to fixed, mobile, DSL, internet TV, as well as other digital services appropriate to each country. Any services not specifically included in these new segments are part of “Other companies and eliminations”.

On March 24th 2015, Telefónica signed an agreement with Hutchison on the sale of Telefónica's operations in the United Kingdom. Therefore, in 2015, Telefónica's operations in the United Kingdom are reported as discontinued operations, and the fair value of the investments due to be sold are classified as "held for sale" in compliance with PGC 2007.

The Telefónica Group’s strategy aims to:

- Enhance value through:
    - Offering excellent connectivity
    - Providing a bundled offer with video and digital services.
    - Increased customer value and customer experience
- With the following enablers:
    - End-to-end Digitalization: reducing our legacy investments to increase virtualization, reduce physical servers, data centers and applications
    - Big Data and Innovation to add value to our customers
    - And continue to work on capital allocation in our legacies and simplification

In addition, Telefónica maintains an industrial alliance with China Unicom. Furthermore, in order to potentially unlock the value of Telefónica’s scale, the "Partners" program was created in 2011, and now includes five operators (Bouygues, Etisalat, Sunrise, Megafon and O2 CZ). The Telefónica Partners Program is an initiative that makes available to selected operators and under commercial terms a host of services that allows partners to leverage on Telefónica’s scale and to cooperate on key business topics (digital services, roaming, services to multinationals, procurement, devices, etc.).

Moreover, Telefónica has increased its presence in key markets. In 2014 Telefónica acquired E-Plus though Telefónica Germany and in 2015 Telefónica acquired DTS though Telefónica Spain and GVT though Telefónica Brazil.

Other information

Non-controlling interests can be divided into two groups. Firstly, subsidiaries listed in a regulated market, such as Telefônica Brasil or Telefónica Deutschland, where minority shareholdings are widely dispersed and in respect of which Telefónica protects minority interests by complying with the regulations of the related market. Secondly, subsidiaries with a main minority shareholder, with whom agreements are entered into in order to guarantee the protection of such shareholder's rights and, in certain cases (such as Colombia Telecomunicaciones) where there are also specific commitments resulting from corporate transactions.

The Telefónica Group's Spanish companies have adapted their internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree-Law 4/2013, amending Law 3/2004, which establishes measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2014 included payment periods of up to 60 days, according to the terms agreed between the parties. For efficiency purposes, the Telefónica Group's companies in Spain have agreed payment schedules with suppliers, whereby payments are made on set days of each month. Payments to Spanish suppliers in 2015 and 2014 surpassing the established legal limit were the result of circumstances or incidents beyond the payment policies, mainly the delay in issuing invoices (legal obligation of the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues. The average payment period to suppliers of Telefónica, S.A. in Spain in 2015, according to the Spanish Law, amounted to 24 days.

The Company has a governance system, which applies to Telefónica's entire structure. Pursuant to the Company's commitment to its shareholders, the Board of Directors, supported by its Committees, manages the Company's business in accordance with the corporate governance rules laid down primarily in the Corporate By-laws, in the Regulation of the General Shareholders' Meeting, and in the Regulation of the Board of Directors.

Telefónica's Board of Directors consists of 18 directors and is responsible for overseeing and controlling the Company's activity. It has sole powers regarding general strategy and policies on corporate governance, corporate social responsibility, remuneration of the Board and senior management, shareholder remuneration, and strategic investments.

In order to strengthen the corporate governance of the Company, the Board of Directors of Telefónica, S.A. has eight committees (including the Executive Commission) which are charged with examining and overseeing areas of particular relevance. Pursuant to its regulation, the Board also confers responsibility for day-to-day management of the businesses to Telefónica's executive bodies (primarily through the Executive Committee) and management team.

Economic results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 8 million euros in 2015. Highlights of the 2015 income statement include:

- Revenue from operations, amounting to 5,900 million euros has decreased year on year, primarily due to the lower dividend distributions from Group companies and associates. The most significant variation comes from Telefónica Internacional, S.A.U. with 1,000 million euros (3,238 million euros in 2014).

- The figure of "Impairment and gains (losses) on disposal of financial instruments" amounting to 4,457 million euros has increased considerably compared to 2014 due to impairment charges recognized to investments in Telefônica Brasil, S.A. and Sao Paulo Telecomunicaçoes, S.A. totalling 2,625 million euros (in 2014 the write down was 735 million euros) and Telefónica Internacional, S.A.U. amounting to 1.142 million euros, no amount in 2014.

- Net financial expense totaled 1,906 million euros in 2015, compared to 2,542 million euros in 2014. This was mainly due to finance costs with Group companies and associates, principally from Telefónica Europe, B.V. amounting to 471 million euros (431 million euros in 2014), Telefónica Emisiones, S.A.U. totalling 1,589 million euros (1,550 million euros in 2014). These effects are offset by the revaluation in the quoted price of Telecom Italia, S.p.A. shares (reflected in the equity value of Telco, S.p.A. investment) since January until the spin off date in June 2015, totalling 411 million euros.

Investment activity

2015

On March 24, 2015 Telefónica, S.A. signed an agreement with Hutchison to acquire Telefónica's operations in the UK. Since the agreement date, the net carrying amount of the investment in Telefónica Europe, plc. subject to the transaction (13,189 million euros) was reclassified under "Non-current assets held for sale". The investment write off in 2015 has been included under the same balance sheet caption amounting to 852 million euros. The write off adjustment in the income statements ended December 31, 2015 have been recognized under "Profit after tax from discontinued operations". 2014 figure amounting to 2,500 million euros has been accordingly reclassified to the same caption.

Once the pertinent regulatory authorizations were obtained on April 27, 2015, and with the aim of raising the funds needed to complete the acquisition of Global Village Telecom, S.A. and its parent company GVT Participaçoes, S.A. the General Shareholdings' Meeting of Telefônica Brasil, S.A. launched a capital increase of 15,812 million reales. Telefónica, S.A. subscribed 3,995 million reales (equivalent to 1.262 million euros). On the same date, and with the object of subscribing the above mentioned capital increase, SP Telecomunicaçoes Participaoes, Ltda approved a capital increase of 3,223 million reales. Telefónica, S.A. paid 1,270 million reales (equivalent to 401 million euros).

On June 24, 2015 and compliance with the undertakings assumed in the agreement entered into for the acquisition of Global Village Telecom, S.A. (GVT), it has, through its 100% subsidiary Telco TE S.p.A., delivered 1,110 million ordinary shares of Telecom Italia S.p.A. (representing 8.2% of its ordinary shares) to Vivendi, S.A. and has received from Vivendi, S.A. all the ordinary shares and part of the preferred shares of Telefônica Brasil S.A. that Vivendi S.A.received as consideration for the sale of GVT, which together represent 4.5% of the total share capital of Telefônica Brasil S.A.The fair value of Telecom Italia shares contributed to Vivendi has been calculated using the quoted price at the date of the transaction amounting to 1,264 million euros. This same amount has been used to value the 4.5% additional investment in Telefônica Brasil, S.A.

On July 29, 2015, Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica has committed to deliver 46.0 million of its treasury shares in exchange for 58.4 million of Telefônica Brasil, S.A. shares, representing aproximately 3.5% of the share capital of Telefônica Brasil, S.A. The execution of the agreement was performed on September 16, 2015 and valued at the quoted price of Telefónica's shares at that date, 538 million euros.

As a consequence of the aforementioned transactions, the direct stake of Telefónica, S.A. in Telefônica Brasil, S.A. was increased to 29.77% and the stake at SP Telecommunicaçoes Participaçoes, Ltda is 39.4% of its capital.

In June 18, 2015 the public deed of Telco, S.p.A.'s spin off transaction was filed to the Companies Register. As a result of the process, Telecom Italia, S.p.A. ordinary shares owned by Telco, S.p.A. (equivalent to a 22.3% of the company's share capital) were transferred to its stakeholders. Therefore, Telefónica, S.A. through a 100% owned newly incorporated subsidiary, Telco TE, S.p.A. received ordinary shares representing 14.72% of Telecom Italia's share capital. In this same spin off process, Telco TE, S.p.A. registered the part of the liability that Telco, S.p.A. owed its stakeholders, pro-rata their percentage of ownership. The net book value of assets and liabilities registered was 603 million euros and it is included as "additions" in the table of movements above.

On the other hand, Telco TE S.p.A. entered into a purchase agreement with a financing institution for the sale of 872 million ordinary shares of Telecom Italia S.p.A., representing 6.5% of the ordinary shares of this company, for an amount of 1,025 million euros.

Likewise, Telefónica has arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia S.p.A., issued by Telefónica, S.A. in July 2014.

Telefónica, S.A. has therefore ended the divesting process of its indirect stake at Telecom Italia, S.p.A., in accordance with the regulatory and competence requirements.

2014

On January 28th, 2014 Telefónica announced that after obtaining the relevant regulatory approval, the sale transaction of the 65.9% of the capital share of Telefónica Czech Republic, a.s. to PPF Group N.V.I. was completed. This concept was registered in 2013 balance under caption “Non-current assets held for sale” for an amount of 2,302 million euros.

On June 16, 2014 the three Italian shareholders of Telco, S.p.A. requested the initiation of the process of "demerger" (spin off) of the company, as provided in the Shareholders Agreement. Implementation of the demerger, approved by the General Meeting of Shareholders of Telco, S.p.A. held on July 9, 2014, was approved in 2015 by anti-trust and telecommunications authorities (including Brazil and Argentina).

At a meeting on December 22, 2014, the Brazilian telecommunications regulator (ANATEL) approved the demerger on condition of suspension of Telefónica’s voting rights in Telecom Italia, S.p.A. and its subsidiaries, among certain other measures. Telefónica agreed with the aforementioned suspension of voting rights and offered the presentation of a formal statement to ANATEL in this regard. Therefore, on the same date Telefónica ceased to have significant influence through its indirect holding in Telecom Italia, S.p.A. and reclassified this investment as an available-for-sale financial asset.

<u>Assessment of impairment of investments</u>

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31, 2015.

As a result of these estimations and the effect of the net investment hedge in 2015, an impairment provision of 4,457 million euros was recognized (1,179 million euros in 2014). This amount derives mainly from the following companies:

(a) write down of 1,872 million euros for Telefônica Brasil, S.A. (559 million euros in 2014) and 753 million euros for Sao Paulo Telecomunicaçoes, S.A. (176 million euros in 2014).

(b) write down of 233 million euros for Telefónica México, S.A. de C.V. (126 million euros in 2014).

(c) write down of 1,142 million euros for Telefónica Internacional, S.A.U., mainly originated by the impact in this subsidiary’s investments of the valuation of its 36,01% stake in Telefônica Brasil, S.A.

(d) write down of 123 million euros for Telcel, C.A. with no amount in 2014.

(e) write down of 267 million euros for Telefónica Digital Holding, S.A.U. (300 million euros in 2014).

The impairment provision in Telefónica Europe, plc is shown, in both 2015 and 2014, under the caption “Discontinued operations”.

The valuation of Telefônica Brasil, S.A. and Sao Paulo Telecomunicaçoes, S.A. was bolstered by the acquisition of GVT in 2015. However, the improvement in operating numbers was significantly impacted by the financial volatility resulting from the country's medium-term economic and political uncertainties.

These economic and financial tensions were felt mainly in the discount rate. As a result, the cost of capital in Brazil increased by 1 p.p. vs. 2014, in line with analysts' expectations. This increase is the result of both higher costs of capital, mainly explained by the increase in the country's risk premium, and higher costs of external finance. The performance of the Brazilian real also generated significant exchange rate losses in 2015, with a 32% depreciation of the currency compared to 2014.

With regard to the full-year growth rate for 2015 (5%), this was not significantly different to that applied in 2014, in line with the analysts' consensus; a conservative approach has also been taken, considering that this rate is consistent with the Brazilian Central Bank's medium-term inflation target (4.5%, within a band of ±2 p.p.), being below the consensus inflation rate expected by analysts over the Strategic Plan horizon (around 6%) and also lower than the forecast nominal GDP growth rate (around 7%).

Turning to the operational side, OIBDA margins over the Strategic Plan horizon have shown an average 1.5 p.p. improvement compared to last year's forecasts. This performance, together with the OIBDA margin used for full-year growth (36%) and the investment rate required for long-term business continuity (16.3%) are consistent with analysts' forecasts. Finally, the synergies deriving from the acquisition of GVT have been incorporated within the time range of the cash flow projections into the valuation, considering both incremental increases in revenues and estimated savings over the coming years.

Share price performance

European equity markets were very volatile in 2015, with the year dividing into two parts. The first part of the year, to August, saw improving macroeconomic indicators and strong performance by exporting sectors, supported by a more competitive euro (as a result of ECB stimulus measures), driving markets upwards. However, uncertainty about economic growth in China and devaluation of the Yuan (increasing volatility for all emerging economy currencies and causing a collapse in commodity prices) and expectations of interest rate increases by the US Federal Reserve (with the first rise since January 2009 taking place on December 16), dragged the markets back from mid-August onwards. Against this backdrop, the performance of European indices varied over the year: CAC-40, +8.5%; DAX, +9.6%; FTSEMIB, +12.7%; EStoxx-50, +3.8%; Ibex-35, -7.2%; and FTSE-100, -4.9%. The Ibex-35 underperformed its peers due to the greater exposure of some of its companies to emerging economies, political uncertainty and the greater weight of exporting sectors in other European indices.

In terms of DJ Stoxx-600 sectors, the gainers in Europe were led by travel and leisure (+19.6%), financial services (+18.7%) and consumer goods (+18.7%), whilst basic materials (-34.9%), energy (-7.8%) and utilities (-3.7%) led the fallers. The telecommunications sector was up 8.5% over the year, 1.7 p.p. higher than the DJ Stoxx-600 (+6.8%), due to operators experiencing a return to revenue growth in general terms and a better outlook for the future, together with announced and expected consolidations.

The Telefónica share ended 2015 at 10.24 euros per share, down 13.2%. This fall is reduced to 7.9% when the dividends distributed in the year (0.40 euros in cash and 0.35 euros in scrip dividend) are included.

In terms of individual shares, there were noteworthy performances by Telecom Italia (+33.2%, driven by consolidation in the domestic market, expectations of corporate actions involving its Brazilian subsidiary TIM, and the entry of significant new shareholders) and Deutsche Telekom (+26.0%, with a positive performance in its domestic market and the possible divestment of its T-Mobile subsidiary). In addition, BT finished the year up 17.5%, Telefónica Deutschland rose by 10.8% and Orange was up 9.4%. On the negative side, Vodafone fell 0.7%, and TeliaSonera was down 16.3%, impacted by corporate governance problems in its investments in Eurasia.

Other leading Spanish companies by stock market capitalization also struggled (Repsol -34.9%, Santander -34.8% and BBVA -14.2%).

At 2015 year end, Telefónica's stock market capitalization stood at 50,921 million euros, the eleventh largest telecommunications company worldwide. The average trading volume in its shares on the Spanish continuous market was 33.7 million shares.

Research, development and innovation

Telefónica remains firmly committed to technological innovation as an essential tool for achieving competitive advantages, anticipating market trends and differentiating its products. By introducing new technologies and developing new products and business processes, we seek to become a more effective, efficient and customer-oriented Group.

Telefónica has developed an open innovation model for the management of the technological innovation to boost the application of technical research in the development of new commercial products and services. Telefónica focuses on certain applied research and development (R&D) priorities that are aligned with its strategy. Open innovation initiatives driving this model include the creation of a venture capital fund and involvement in business collaboration forums, among others. The model also promotes the use of knowledge developed at technology centers, universities and start-ups, among other sources, and encourages innovation in conjunction with other agents (e.g. customers, universities, public administrations, suppliers, content providers and other companies), making them "technological partners." In the frame of this open innovation strategy, during 2015 the Open Future initiative has been consolidated.

Telefónica believes that differentiate their products from competitors and enhance market position cannot rely solely on acquired technology. It is also important to promote R&D in an effort to achieve this differentiation and to advance other innovation activities. The policy of the Group R & D is aimed at:

- Develop new products and services in order to win market share;
- Boost customer loyalty;
- Increase revenue;
- Enhance innovation management;
- Improve business practices;
- Increase the quality of infrastructure services to improve customer service and reduce costs;
- Promote global products;
- Support open innovation;
- Create value from the technology generated.

In 2015, the technological innovation projects undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of presence in new markets and technological leadership.

The technical innovation activities are a key of Telefónica's strategy to create value through latest-generation network communications and services.

In 2015, projects were undertaken to promote the increase of access to information technology, new services focused on new internet business models, advanced user interfaces, TV distribution, multimedia content and other added-value services leveraging on the potential of the new infrastructures. These initiatives, among others, were undertaken based on our objective of rapidly identifying emerging technologies that could have a relevant impact on our businesses and test the pilot technologies in relation of our new services, applications and platform prototypes.

Most of our R&D activities are carried out by Telefónica Investigación y Desarrollo, S.A.U. (Telefónica I+D), a wholly-owned subsidiary, which works mainly for the lines of business. In its operations, Telefónica I+D receives the assistance of other companies and universities. Telefónica I+D's mission is centered on enhancing the Company's competitive positioning by leveraging technological innovation and product development. Telefónica I+D undertakes experimental and applied research and new product development with the overriding goal of broadening the range of services offered and reducing operating costs.

Telefónica I+D's technological innovation activities are focus on two big areas:

1. Telefónica I+D's works for the development of new networks, primarily in collaboration with Telefónica's Global Resources team. These activities are related with new radio access technologies and fiber; network

virtualization technologies, in line with the technology trend known as software defined networks (SDN); and network optimization and zero touch developments making networks more flexible and moldable and able to adapt dynamically to new digital consumer and service requirements.

2. R&D activities to develop new products and services which are conducted as part of the digital services strategy are the following:

   - Natural P2P communication of the future, using the Internet and smartphones.
   - Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.
   - Advanced solutions in emerging ITC businesses such as cloud computing, security, financial services or e-health.
   - M2M (machine-to-machine) service management associated with energy efficiency and mobility and with the Internet of Things and their adoption in the urban and industrial scenario, and as a service creation enabler.
   - Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.)

With a view over the medium and long term, Telefónica I+D's also boasts scientific work groups aim to look into opportunities relating to new networks and services and solutions to the technological challenges that arise.

In 2015, the new Telefonica I+D center in Chile -launched in 2014 in collaboration with the Chilean government- was consolidated with the launch of the first MVP (Minimum Viable Product), in the field of Smart Cities, Smart Industry and Smart Agro.

At December 31st, 2015, Telefónica I+D had 654 employees (652 employees in 2014).

The total I+D expense in the Group for 2015 amounted to 1.012 million euros, down 0.9% from the 1,021 million euros incurred in 2014 (959 million euros in 2013). This expense represents 2,1%, 2.3% and 1.9% of the Group's consolidated revenue for 2015, 2014 and 2013, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

During 2015, Telefónica filed 21 new patent applications, where 2 of them registered through the United State Patent and Trademark Office (USPTO) and 19 through the Spanish Patent and Trademark Office (OEPM), of which 9 are International applications (PCT). Additionally 2 utility models were filed, also through OEPM.

Environment

Environmental policy, control of environmental risks and climate change

Telefónica has an Environmental Policy which is applicable to all of its companies, which sets out the road map for the company to advance towards a green economy, reducing the environmental impact of its facilities at the same time as developing the potential for digital services to reduce the environmental footprint of other sectors.

Currently over half of the companies in the Group have Environmental Management Systems (EMS) in accordance with Regulation ISO 14001, certified by an external body, which contribute to the proper management of the environmental aspects of the company and to extending a culture of environmental responsibility across the whole supply chain. Telefónica has set itself the target of certifying 100% of operators under ISO 14001 by 2017.

Telefónica's environmental risks and climate change are controlled and managed under the company's global risk model. The environmental aspects of the telecommunications operations are mainly focused on the risk of high geographical dispersion and energy consumption, which is controlled by means of environmental management based on uniform processes and a global energy efficiency programme.

Telefónica has a global environmental team made up of experts in environmental management in each of the Group's companies.

Common minimum standards - Responsible Network

Environmental legislation, which is abundant in almost all of the countries where Telefónica operates, applies mainly to our network infrastructures. Among these, it is worth mentioning the need to obtain environmental permits for base stations, waste management, noise control and measuring electromagnetic fields.

Telefónica has common standards for all of its companies, in harmony with the principle of caution, establish minimum guidelines for environmental management with the aim of minimising the impact of infrastructures, these standards go beyond existing legislation. Also, these standards extend to all of our suppliers and contractors.

Among the activities which the Group carries out in order to manage the environmental aspects of its operations, are the design and optimal transmission of new sites for network rollout, promoting shared infrastructure with other operators and the development of adjustments to reduce the visual impact of mobile phone antennas.

Main lines of action

Within the Responsible Business Strategic Plan, the company has established lines of action regarding the environment. This plan is also grounded in each county in order to be able to focus on the most relevant aspects at a local level. Some of the lines of action are:

- Energy and climate change - by means of the Corporate Climate Change Office the company promotes energy efficiency and the reduction of Telefónica's carbon footprint. Currently, under a structured corporate management model and an energy management figure in each country, an Energy Efficiency Programme is being carried out in each country, which has managed to make a reduction of 500 GWh in 5 years with almost 300 projects, and avoid the emission of over 140 Kt of CO2. Telefónica has corporate energy and emissions reduction targets, 30% KWh/access to the network and 10% KWh/used in offices by 2015, the new framework of objectives for 2020 are currently being defined. Also, over 15% of the company's electrical consumption comes from renewable sources. Thanks to all of this, in 2015 Telefónica has been recognised by the Carbon Disclosure Project, the best index of investment in climate change on a global level, as one of the leading companies in its sector for managing energy and carbon.

- Circular economy - The Company is committed to promoting a circular economy, in which goods used are returned to the value chain. Thus, waste coming from Telefónica networks and customers, with a particular focus on discarded electrical and electronic devices, are managed by authorised entities, in compliance with environmental legislation and prioritising management in the following order: reduce, reuse, and recycle. All companies in the group have waste management programmes and recycling and/or reuse initiatives for managing customers' devices.

- Green Services- in the current context, in which environmental and climate change challenges affect society as a whole, Telefónica is developing services, mainly Machine to Machine (M2M) and the Internet of Things (IoT), aimed at reducing the consumption of resources and the environmental impact of our customers. Telefónica is making a big play for the IoT, it is estimated that it will generate 11 billion euros in 2025. According to current forecasts, the IoT could reduce 200 million tonnes of CO_2 emissions, approximately 23 % of the target set for 2030 by the European Union. Telefónica wants to position itself therefore as a key actor in the green economy.

These actions have allowed Telefónica to extend its environmental responsibility to residential and business customers and to continuously respond to the demands of responsible environmental management from investors and shareholders.

Other aspects related to corporate social responsibility

Responsible business

Our customers, employees, investors, suppliers and society in general expect us to contribute to the sustainable economic and social development of the countries in which we operate, and in order to respond to these expectations, the aims of economic, social and environmental sustainability go hand in hand with the strategic objectives of the Company itself.

We have made commitments to our different interest groups by means of our principles of Responsible Business, in which we define the basic values which underpin all of our actions (we want to be an open, challenging and reliable company), the ethical principles which guide our way of doing business and our specific commitments in the different areas for the company. Compliance with the law at all times, respect for human rights all across our value chain, assuming our fiscal responsibility and commitment to the environment and social development are some of the principles which are reflected in this document.

Our specific sustainability objectives are set out in a Responsible Business Plan, which goes across all company departments and identifies the big challenges which we are setting ourselves regarding sustainability. It is based on an analysis of the expectations of our customers, employees, investors and suppliers, the regulator and the challenges facing society in general, as well as the company strategy itself and our risk map. The projects in the Plan include objectives regarding ethical behaviour, customer promises, environmental impact and climate change, sustainable management of the supply chain, digital trust and management of diversity and talent, and sustainable innovation.

Also, through Telefónica Digital Education and the Telefónica Foundations, we are pouring everything we know about education, entrepreneurship and digital skills into a number of social projects aimed at children, teenagers, parents and educators, in order to contribute to reducing the social gaps which surround us.

We have updated our plan and our aims according to the expectations of our interest groups, taking advantage of the many communication channels at our disposal. We have specific channels of communication for employees, suppliers and other interest groups. We use different tools in order to gather the views of our customers and society in general and we proactively promote conversations with our investors.

The Responsible Business Plan has been approved by Telefónica's Administrative Board, along with the strategy for participation and dialogue with our interest groups and the sustainability risk map, and there is a copy in all operators in the group.

The Committee on Institutional Affairs is responsible for following up on the plan and the indicator control panel. Each operator also has a Responsible Business Office, which represent the heads of all of the business departments, which follows up on the plan and supervises the processes which have been implemented to ensure the ethical and responsible conduct of the company.

The company's risk map is drawn up by the company's auditing department and includes both financial and non-financial risks - among others operational, technological, legal, social, environmental, political and reputational - under the direct supervision of the Auditing Commission. The risk map not only identifies and quantifies the relevant risks across the company, but also the mitigation plans for said risks.

Our commitment to Human Rights

We are committed to the human rights recognised and included in the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights, the International Labour Organization, the 8 core conventions on fundamental human rights, the WTO Convention 169 on the Rights of Indigenous Peoples, the UN Convention on the Rights of the Child and the UN Convention on the rights of persons with disabilities. We have incorporated concrete objectives into our Responsible Business Plan around respect for and promotion of human rights in projects such as the sustainable management of our supply chain, diversity, privacy and security, and other projects showing our commitment to the communities in the countries in which we operate.

Our Fiscal Responsibility

Regarding our fiscal responsibility, we adhere to the Code of Good Tax Practices, drawn up by the Forum of Large Companies in conjunction with the Spanish Tax Administration, with the aim of avoiding the use of structures of an opaque nature for tax purposes. To this end, we do not use company structures in order to cover or reduce the transparency of our activities before the tax authorities, or any other interested party. Nor are we present in any of the jurisdictions included in the list of tax havens established in Spanish regulations.

Human Resources

Social objectives and policies

At Telefónica people are important and are the core of the business, representing one of the Group's greatest assets. Our aim as HR department is to develop our employees' capacities to the maximum in order to fulfill the compromises agreed with our customers.

Our vision is based on five main pillars:

- Recruit, develop and keep the talented employees to ensure the Company meets its strategic goals.
- Support the business units integration and the transformation process so that the companies are aligned with the business objectives.
- Build a customer-focused organization culture.
- Offer a global HR service for managers and employees based on enpowerment and simplification.
- Become a 100% online department with high self-service options in the HR processes and with outsourced resources.

Telefónica faces a great transformation in order to continue as a leader in the new digital environment. Therefore, Human Resources dapartment plays a leading role both in the development of the employees and in its own transformation process. In 2015 the progressive use of SuccessFactors –the new digital, on-line, multi-gadget, cloud based and global tool for HR management- implied all global employees. The highlights of this change are the review and unfification of the following global processes such as performance, replacements, recruits and training.

Employee training

Just like in the rest of Telefonica´s business operation units, in Telefónica S.A. employee training is an absolute priority, in these times of deep change and evolution fir the company. In 2015 most of the L&D efforts where devoted to transforming the company into a "Digital Telco", leveraging on specific training programs by Universitas Telefonica conceived for the whole headcount and at the same time adapting the traditional training programmes to digital training enabling the employees to increase their learning capacities through the online Training Schools: Technical, Commercial, Leadership, Languages, Finance and Coaches.

Universitas Telefonica operates at two levels: on premises and virtual programs. On premises programs are delivered both at our campus in Barcelona where more than 288 employees from TSA participated in our leadership transformation programs, plus 110 employees more, trained in our local offices in Madrid and Brazil. Moreover, some employees from the new units such as TGS and CCDO were trained on premises. In all cases the programs are focused on Telefonica´s transformation.

In 2015, over 41,000 training hours were carried out. For the Company, managing knowledge is a priority. In 2015, the cost of training amounted to 3 million euros.

Managing diversity

Telefónica understands diversity management as a business opportunity. A team of diverse professionals:

1) identifies the needs of our customers, diverse too and provides the service they need;

2) generates innovation: different people thinking different;

3) diverse teams perform better and more productive results.

Our Business Principles include the basic right to equality:

"We support equal opportunities and treat all persons in a fair and impartial manner, with no prejudices in respect of race, color, nationality, ethnic origin, religion, gender, sexual orientation, marital status, age, disability or family responsibilities".

The concept of diversity, however, reaches well beyond this - it is a fundamental value and intrinsic value to us: Telefonica has profesionals from more than 24 countries (four of them sit on the Board of Directors) representing more than 100 nationalities.

In terms of the male/female distribution of our total headcount, at December 31, 2015 Telefónica had 129,916 employees. There were 49,159 professional female employees, or 38% of the total, and 80,757 male employees, accounting for the remaining 62%. The percentage of women reaches the 19% in the management level.

For all these reasons Telefónica positions the Diversity project as a strategic project as part of its Responsible Business Plan presented in the Committee on Institutional Affairs headed by Julio Linares and under the Council.

In 2015 there has been a significant raise in awareness among the executive committees of local operators. As a result of these meetings, Company executives have become sponsors of the project as to promote diversity on the local level, which in turn are to be grouped around a Global Committee managed by the global sponsor and member of the Group Executive Committee.

Furthermore, the development of the career acceleration program for women (Women in Leadership) during the last year is remarkable. 100 professional women of the Group have passed through this program.

Managing talent

Telefónica's main goals are to develop the talent of its employees, give them the chance to shape their professional and personal lives, and provide them with constant support for their own personal development.

Assessment of talent produces a management talent map of the entire Company, and a structured succession plan.

It is a basic management tool that sets us apart from the rest and implements a culture of meritocracy to facilitate decision-making concerning aspects such as development, organization, compensation etc.

In 2015, a project of talent oriented definition and identification of the profile for the digital transformation of Telefónica was made: first an analysis to understand what capabilities are needed to successfully face the current changes and future changes was developed. The key capabilities identified are the ability to learn, the ability to transform and the ability to quickly adopt new technologies. From there more than 1,300 directors and junior directors from 26 countries were invited to participate in an exercise that has allowed to bring together professionals based on their strengths in 4 profiles that provide us with skills, knowledge and different experiences: Profile Core, core for the development and execution of business; Profile Transformer, able to mobilize the organization; Digital Profile, people who learn experiences where new technologies are key; and Transformer Digital Profile, driving people from the digital transformation within the company.

Occupational health and safety

One of Telefónica’s priorities is to offer its staff the best possible working conditions at their place of work or when they are on the move.

As per its Business Principles, Telefónica ensures staff work in a safe environment. Appropriate mechanisms are therefore in place to avoid workplace accidents, injuries and illness associated with professional activities by fully complying with prevailing regulations, implementing safe working procedures, providing training and managing occupational risks.

The Occupational Risk Management System ensures worker health and safety is at the heart of all Telefónica’s processes and services; offering an end-to-end model for rolling out joint action, procedures and policies. This system enables Telefónica to identify and disseminate practices that are proven to have an impact on staff welfare and therefore on reducing accident rates.

Liquidity and capital resources

Financing

The main financing transactions carried out in the bond market in 2015 are as follows:

			Nominal amount (millions)			
Description	Issue date	Maturity date	Currency	Euros	Currency of issue	Coupon
Telefónica Emisiones, S.A.U.[1]						
EMTN bonds	06/18/15	06/19/17	300	300	EUR	Euribor 3M+0.33%
	09/14/15	09/14/21	1,000	1,000	EUR	1.477%
	12/11/15	12/11/17	100	100	EUR	Euribor 3M+0.53%

(1) Guaranteed by Telefónica, S.A.

The main financing transactions carried out in the bank market in 2015 are as follows:

Item	Limit	Currency	Outstanding balance (millions of euros)	Arrangement Date	Maturity date
Telefónica, S.A.					
Syndicated loan	2,500	EUR	500	02/19/2015	02/19/2020
Bilateral loan	200	EUR	200	06/30/2015	06/30/2020
Syndicated loan	3,000	EUR	-	11/17/2015	02/17/2018
Structured Financing (*)	750	USD	-	12/11/2015	03/11/2026
Structured Financing (*)	500	EUR	-	12/11/2015	03/11/2026

(*) Facility with amortization schedule.

Available funds

At December 31, 2015, available funds from undrawn lines of credit in different financial institutions totaled 11,705 million euros (of which 10,974 million euros maturing in more than 12 months). Additionally, cash and cash equivalents as of December 31, 2015 amount to 110 million euros.

Additional information on sources of liquidity and undrawn lines of credit available to the Company, on liquidity risk management, on the Company's debt levels, and on capital management is provided in Notes 13, 14, 15 and 16 of the financial statements.

Contractual commitments

Note 20.c) to the financial statements provides information on firm commitments giving rise to future cash outflows and associated with operating leases, primarily.

Credit risk management

The credit risk in Telefónica, S.A. mainly refers to the one associated with financial derivative instruments arranged with different entities. The detailed description of how those risks are managed and hedged is included in Note 16.

Credit rating

At December 31, 2015, Telefónica, S.A.'s long-term issuer default rating is "BBB+/stable outlook" from Fitch, "Baa2/stable outlook" from Moody's and "BBB/positive outlook" from Standard & Poor's. The most recent updates on these ratings were issued by Fitch on June 26, 2015, Standard and Poor's on May 28, 2015 and Moody's on March 25, 2015. The changes in the long-term issuer default rating and outlook for Telefónica, S.A. during 2015 were that Moody´s revised the outlook to "stable" from "negative" on March 25, 2015 and Standard and Poor's revised the outlook to "positive" from "stable" on May 28, 2015.

In 2015, among the measures taken to help to protect the credit rating, it is noteworthy the financing activity together with a liquidity policy, the implementation of part of the dividend as a scrip dividend (instead of cash only dividend) in the fourth quarter of 2015, a portfolio management through the announced disposal of O2 UK , the rights issue to finance the GVT acquisition or the issuance of undated deeply subordinated securities as a solvency protection measure to mitigate negative impacts on our financial statements.

Dividend policy

Telefónica, S.A.'s dividend policy is revised yearly based on the Group's earnings, cash generation, solvency, liquidity, flexibility to make strategic investments, and shareholder and investor expectations. In 2015, the Annual General Meeting approved to pay a dividend, via scrip dividend of approximately 0.35 euros per share in November 2015, and the Board announced its intention to take corporate actions to approve another cash dividend of 0.40 euros per share in the second quarter of 2016.

In November 2015, Telefónica launched a scrip dividend issue to allow shareholders to choose to receive new shares in place of a cash dividend (which may be replaced by selling the associated subscription rights to the Company at a pre-established price), while enabling the Company to reduce its debt, depending on the take-up rate of the conversion.

Treasury shares

Telefónica has performed, and may consider performing, transactions with treasury shares and financial instruments or contracts that confer the right to acquire treasury shares or assets whose underlying is Company shares.

Treasury share transactions will always be for legitimate purposes, including:

- Undertaking treasury share acquisitions approved by the Board of Directors or pursuant to General Shareholders' Meeting resolutions.
- Honoring previous legitimate commitments assumed.
- Covering requirements for shares to allocate to employees and management under stock option plans.
- Other purposes in accordance with prevailing legislation. In the past, treasury shares purchased on the stock market were exchanged for other shares-securities (as in the case of preferred capital securities), swapped for stakes in other companies (e.g. China Unicom or Telco S.p.A.), or acquired to reduce the number of shares in circulation (by redeeming the shares acquired), thereby boosting earnings per share.

Treasury share transactions will not be performed in any event based on privileged information or in order to intervene in free price formation. In particular, any of the conduct referred to in Articles 83.ter.1 of the Spanish Securities Market Law and 2 of Royal Decree 1333/2005 of November 11 implementing the Spanish Securities Market Law, with regards to market abuse will be avoided.

At December 31, 2015 and 2014, Telefónica, S.A. held the following treasury shares:

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/31/15	141,639,159	11.69	10.24	1,450	2.84690%

(1)Millions of euros

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/31/14	128,227,971	11.68	11.92	1,528	2.75332%

(1)Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2015 and 2014 is as follows:

	Number of shares
Treasury shares at 12/31/13	**29,411,832**
Acquisitions	100,723,415
Disposals	(129,177)
GESP share plan delivery	(1,778,099)
Treasury shares at 12/31/14	**128,227,971**
Acquisitions	138,036,450
Disposals	(47,824,300)
Share redemption	(74,076,263)
PIP II share plan delivery (Note 19.3)	(2,724,699)
Treasury shares at 12/31/15	**141,639,159**

Acquisitions

The amount of the acquisitions of treasury shares in 2015 and 2014 was 1,654 million euros and 1,176 million euros, respectively.

Share redemption and disposals

On July 24, 2015, pursuant to the resolution of the share capital reduction, by the cancellation of own shares, adopted by the Annual General Shareholders' Meeting of Telefónica held on June 12, 2015, and following the execution agreement adopted by the Board of Directors of the Company, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (Registro Mercantil). Therefore, 74,076,263 of the own shares of Telefónica, S.A. totalling 886 million euros have been cancelled, reducing the company's share capital by 74 million euros.

Treasury shares sold in 2015 and 2014 amounted to 593 million euros and 1 million euros, respectively. The main treasury share sale transaction was on July 29, 2015 when Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica has committed to deliver 46.0 million of its treasury shares, representing 0.95% of its share capital at the date, in exchange for 58.4 million preferred shares of Telefônica Brasil, S.A. (received by Vivendi, S.A. in the context of the acquisition of GVT Participaçoes, S.A.), representing 3.5% of the share capital of Telefônica Brasil, S.A. The execution of this agreement took place in September 2015, once the approval by the Brazilian competition authority (CADE) was obtained. The impact in equity amounts to 555 million euros.

On June 30, 2015, the second phase of the Telefónica, S.A. long-term incentive plan called "Performance and Investment Plan 2012-2015" ("PIP 2012-2015") ended. According to the level of "Total Shareholder Return" (TSR) achieved, 77%, 2,724,699 shares were delivered. In addition to these disposals, on November 28, 2014, 1,778,099 shares were delivered to Group employees when the second phase of the Global Employee Share Plan ("the GESP") matured.

Options on treasury shares

At December 31, 2015, Telefónica had cancelled all the call option contracts on treasury shares subject to physical delivery at a fixed price (76 million options on treasury shares at December 31, 2014), which were presented as a reduction in equity under the caption "Treasury shares". They were valued, in previous periods, at the amount of premium paid, and upon maturity if the call options were exercised the premium was reclassified as treasury shares together with the price paid. If they were not exercised upon maturity their value was recognized directly in equity.

The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 33,8 million of Telefónica shares in 2015 (32 million shares in 2014), recognized in both years under "Current interest-bearing debt" in the accompanying balance sheet.

Risks and uncertainties facing the Company

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

Group-Related Risks

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

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

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

Growth in Europe may be affected by political uncertainty in some European countries (including Spain), a possible revival of the crisis in Greece, restructuring of the banking sector, the impact of steps taken towards a EU banking union and a capital markets union and the referendum to be held in the near future in the United Kingdom, among others. In 2015, the Telefónica Group obtained 26.3% of its revenues in Spain and 16.7% in Germany.

In Latin America, higher exchange rate risks stand out after the large depreciation undergone by most currencies in this region, affected by the fall in commodity prices, the uncertainties about growth in China, and the interest rate evolution in the United States, among other macroeconomic factors. Abrupt exchange rate movements could especially be triggered by scenarios characterized by high inflation and fiscal and external deficits. In this regard, it should be noted that the Venezuelan bolivar exchange rate quoted in SIMADI has remained stable for a year despite the high increase in prices accumulated over this period, increasing the risk of readjustment. In addition, the Argentine peso (which already experienced a sharp depreciation in December 2015) is experiencing some depth constraints in its trading market, and the Brazilian real (which also experienced a depreciation in 2015) has remained volatile at the beginning of 2016. Cash flows from countries in this region could decrease, and financial conditions could become more unfavorable if any of these elements were to worsen in the future.

Some of the most significant macroeconomic risk factors in the region affect Brazil, where there is a combination of high inflation, negative economic growth rates and significant internal and external financing needs. All these elements have led to new downgrades to the country's credit rating.

Moreover, the recent fall in oil prices and other commodity prices is having a negative impact on the external and fiscal accounts in Chile, Peru, Colombia, Mexico, and Ecuador (which has a dollarized economy, and is currently experiencing a lower supply of U.S. dollars).

In Argentina, the new government is focused on resolving Argentina's macroeconomic and financial imbalances and on recovering international confidence. Although reforms taking place may have positive effects in the medium term, short term risks persist.

In Venezuela after the parliamentary elections in which the Democratic Unity Roundtable (an opposition coalition to the ruling United Social Party of Venezuela) claimed the majority of seats in the National Assembly, a new economic emergency decree was announced which could increase state control on private businesses. In addition, there continues to be very limited access to U.S. dollars.

For the year ended December 31, 2015, Telefónica Hispanoamérica and Telefónica Brazil represented 30.5% and 23.4% of the Telefónica Group's revenues, respectively. Moreover, approximately 35.6% of the Group's revenues in the telephony business were generated in countries that do not have investment grade status (in order of importance Brazil, Argentina, Ecuador, Venezuela, Nicaragua, Guatemala, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. At December 31, 2015 the percentage of Telefónica's net financial debt in Latin American currencies stood at 13%.

“Country risk” factors include the following, among others:

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

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

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

At December 31, 2015, 49.1% of the Group’s net debt was pegged to fixed interest rates for a period greater than one year, while 28% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2015: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 245 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, the U.S. dollar and the pound sterling (these to zero rates in order to avoid negative rates), would lead to a reduction in financial expenses of 75 million euros. These calculations were made assuming a constant currency and a balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

According to the Group’s calculations, the impact on net financial expense by changes in the value of a 10% depreciation of Latin American currencies against the U.S. dollar and a 10% depreciation of the rest of the currencies against the euro would result in exchange losses of 33 million euros, primarily due to the weakening of the Venezuelan bolívar fuerte and the Argentine peso. These calculations were made assuming a constant currency position with an impact on profit or loss at December 31, 2015, including derivative instruments in place. At December 31, 2015, 31.3% of the Telefónica Group’s operating income before depreciation and amortization (OIBDA) was concentrated in Telefónica Brazil and 38.2% in Telefónica Hispanoamérica.

The Telefónica Group uses a variety of strategies to manage these risks, mainly through the use of financial derivatives, which themselves also expose us to risk, including counterparty risk. Furthermore, the Group’s risk management strategies may not achieve the desired effect, which could adversely affect the Group’s business, financial condition, results of operations and cash flows.

Existing or worsening conditions in the financial markets may limit the Group’s ability to finance, and consequently, the ability to carry out its business plan.

The performance, expansion and improvement of the Telefónica Group’s networks, the development and distribution of the Telefónica Group’s services and products, the development and implementation of Telefónica’s strategic plan and new technologies, the renewal of licenses or the expansion of the Telefónica Group’s business in countries where it operates, may require a substantial amount of financing.

A decrease in the liquidity of the Company, a difficulty in refinancing maturing debt or raising new funds as debt or equity, could force Telefónica to use resources allocated to investments or other commitments to pay its financial debt, which could have a negative effect on the Group’s business, financial condition, results of operations or cash flows.

Funding could be more difficult and costly in the event of a significant deterioration of conditions in the international or local financial markets (especially considering the recent volatility resulting from uncertainties regarding China, the decline in commodity prices and the hikes in interest rates approved by the Federal Reserve, all of which impact Latin America), or if there is an eventual deterioration in the solvency or operating performance of the Company, or if Telefónica’s divestment of its operations in the United Kingdom were to not be completed, or as a consequence of a credit rating downgrade of Spanish sovereign risk by rating agencies.

At December 31, 2015, gross financial debt scheduled to mature in 2016 amounted to 11,275 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2017 amounted to 8,461 million euros.

In accordance with its liquidity policy, the Company has fully covered its gross debt maturities until the end of 2016 with cash and credit lines available at December 31, 2015, including a syndicated credit facility signed in November 2015 with several national and foreign institutions amounting to 3,000 million euros with a maturity of up to 27 months. Our liquidity could be affected if Telefónica's divestment of its operations in the United Kingdom is finally not consummated, or if market conditions make it difficult to renew existing undrawn credit lines, 8.7% of which, at December 31, 2015, were scheduled to mature prior to December 31, 2016.

In addition, given the interrelation between economic growth and financial stability, the materialization of any of the economic, political and exchange rate risks referred to above could lead to a negative impact on the availability and cost of Telefonica's financing and its liquidity strategy; which could have, as well, a negative effect on the Group's business, financial condition, results of operations or cash flows.

Telefónica's divestment of its operations in the United Kingdom may not materialize.

On March 24, 2015, Telefónica and Hutchison signed an agreement for the acquisition by the latter of Telefónica's operations in the UK (O2 UK) for a price (firm value) of 10,250 million pounds sterling in cash (approximately 14,000 million euros at the exchange rate as of the date of the agreement), composed of (i) an initial amount of 9,250 million pounds sterling (approximately 12,640 million euros as of the date of the agreement) which would be paid at closing and (ii) an additional deferred payment of 1,000 million pounds sterling (approximately 1,360 million euros) to be paid once the cumulative cash flow of the combined company in the United Kingdom has reached an agreed threshold.

Completion of the transaction is subject to, among other conditions, the approval of the European Comission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties. As of the date of the issuance of these Financial Statements, such conditions had not been met. The European Commission authorization process is ongoing.

As completion of the share purchase agreement is conditional on the satisfaction (or, if applicable, waiver) of certain conditions, the acquisition may or may not proceed. If the abovementioned divestment is ultimately not consummated, or it is consummated under conditions other than those initially reported, this could have a material adverse effect on the trading price of Telefónica's ordinary shares, bonds and financial instruments, and its leverage.

Risks Relating to the Group's Industry

The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.

The telecommunications sector is subject to laws and regulations in different countries, and additionally, many of the services the Group provides require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to spectrum availability. Among the main risks of this nature are those related to spectrum regulation and licenses/concessions, rates, Universal Service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality.

Thus, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies' decisions, such as economic fines for serious breaches in the provision of services and, potentially, revocation or failure to renew these licenses, authorizations or concessions, or the granting of new licenses to competitors for the provisions of services in a specific market.

In this regard, the Telefónica Group pursues its license renewals in the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality, service and coverage standards and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession. Additionally, the Telefónica Group could be affected by regulatory actions carried out by the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses.

Moreover, the fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations. For example, regulations fix the rates that Telefónica charges for calls received from other companies' networks, and regulators have progressively lowered these rates in recent years. In addition, and particularly in Spain, regulators have promoted competition in recent years by, for example, adopting policies which allow alternative operators access to Telefónica's networks. This intense competition has exerted downward pressure on Telefónica's tariff structure, adversely affecting revenues, and led to increased commercial expenses, adversely affecting margins.

Regulation of spectrum and government licenses

Further to the European Commission's new "Digital Single Market" (DSM) Strategy, Europe is expected to undergo an important review of its regulatory framework. The new European DSM Strategy comprises a series of policy initiatives to promote the development of the single market of digital services and networks. As a result, the European Commission will initiate legislative processes, which could have significant implications on access to network, spectrum use, auction conditions, duration and renewal of licenses, audiovisual services and platforms, among other various matters.

On May 8, 2015, the European Commission approved a Decision on the harmonization of the 1452 - 1492 MHz frequency band (1500 MHz band), which encourages Member States to designate and to make available this band frequency from November 2015, on a non-exclusive basis. As a result, new spectrum award processes are expected in the short and mid-term all across the EU. Germany and the United Kingdom have already auctioned the band frequency and therefore the Decision will not have a material impact on Telefónica's cash flow in those markets. In Spain, the Government launched a consultation which ended on June 21, 2015 to evaluate demand for spectrum in the 1500 MHz band. The tender of the 1500 MHz band in Spain may take place during 2016.

Additionally, the main terms of the allocation and use of the 700 MHz band in Europe is expected to be decided in the coming months. This could require new cash outflows from Telefónica between 2018 and 2021 (the period over which it is expected that the spectrum will be available), except in Germany which was the first country in Europe to award spectrum in the 700 MHz band, together with the 1800 MHz, 900 MHz and 1500 MHz bands.

Further, in Germany, on July 4, 2014 and September 25, 2015, the German Federal Network Agency (BnetzA) adopted decisions concerning the impact of Telefónica Deutschland Holding AG merger with E-Plus Mobilfunk GmbH & Co. KG (E-Plus) on the spectrum held by Telefónica Deutschland (the surviving entity after the merger). BnetzA has required Telefónica Deutschland to terminate by June 30, 2016 (rather than December 31, 2016) some rights of use with respect to spectrum in the 1800 MHz band that was not reacquired by Telefónica Deutschland at the abovementioned auction proceeding. The remaining 1800 MHz spectrum band that was not reacquired in such auction was returned at the end of 2015. The German regulator also announced that it will perform a frequency distribution analysis, and determine whether any additional action is needed, particularly in the area of the 2 GHz spectrum band granted to Telefónica Deutschland.

United Internet and the regional cable operator Airdata have filed complaints against the EU General Court decision allowing the merger between Telefónica Deutschland Holding AG and E-Plus Mobilfunk GmbH & Co. Telefónica Deutschland has been accepted as an interested party in these proceedings.

In the United Kingdom, licenses were amended in January 2015 to introduce a 90% geographic coverage obligation for voice and text services. Separately, on September 24, 2015, the telecommunication regulator (Ofcom) issued a decision to increase the annual fees which mobile operators must pay for the use of 900 MHz and 1800 MHz spectrum. Accordingly, from October 31, 2015, the annual charge that Telefónica UK must pay is 32.2 million pounds sterling (increased from 15.6 million pounds sterling), rising to 48.7 million pounds sterling plus CPI from October 31, 2016. Finally, following consultation, on December 3, 2015 Ofcom published an update stating that it has decided to initiate an auction procedure to award 2.3 GHz and 3.4 GHz spectrum once decisions have been made by the relevant competition authorities, in relation to the proposed merger between Telefónica UK Limited and Hutchison 3G UK Limited.

In Latin America, spectrum auctions are expected to take place implying potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2016 are:

- Peru: In August 2015, the government published the conditions for granting licenses in the 700 MHz spectrum band (three blocks of 2x15 MHz have been defined). On November 4, 2015 Telefónica was declared as a prequalified bidder.
- Costa Rica: In December 2015, the Government communicated its intention to auction 40 MHz in the 1800 MHz band and 30 MHz in the 1900/2100 MHz band during 2016.

- Mexico: The Federal Telecommunications Institute (IFT) has proposed to auction spectrum in the 2500 MHz band in 2016. In addition, and in light of the constitutional reform resulting from the "Pact for Mexico" political initiative, a wholesale network offering services in the 700 MHz band will be created under a Public-Private Partnership (PPP). On January 29, 2016, the SCT (*Secretaría de Comunicaciones y Transportes*) published the rules for the International Competitive Tender. The rules state that the contract will be awarded in August 2016 and commercial operations must begin no later than March 31, 2018.
- Panama: On December 4, 2015, the process of reallocation of the AWS band (140 MHz, 1710-1780 / 2110-2180 MHz) was announced. It is expected to start by the end of 2016.
- Uruguay: The Government approved a resolution allowing for a spectrum auction for mobile services. The auction will contain 15 + 15 MHz in the "AWS Ext" spectrum band and 45 + 45 MHz in the 700 MHz spectrum band (20 + 20 MHz of the 45 + 45 MHz in 700 MHz were previously reserved for the National Telecommunications Administration, ANTEL). As of the date of this report, this process has been delayed and the bidding rules for spectrum have not yet been published.
- Colombia: The regulator has published a consultation document for comment which analyzes alternatives and other considerations regarding the structuring of the allocation process for radio spectrum in the 700 MHz bands (which is part of the "Digital dividend", which is the set of frequencies that have been available to mobile communications services in the frequency bands traditionally used for television broadcast (700 MHz and 800 MHz) due to the migration from analogue TV to digital TV), 900 MHz, 1900 MHz and 2500 MHz for mobile services. The first auction is expected to take place in 2016. Colombia has established spectrum caps for lower bands, which are currently set at 30 MHz, and Telefónica has 25 MHz in lower bands.
- Venezuela: The regulator has indicated the possibility of awarding spectrum in the 2600 MHz band (20 + 20 MHz) for 4G services, in the 1900 MHz band (5 + 5 MHz) for 3G services and in the 900 MHz band during 2016.

In December 2015, the Brazilian regulatory authority (Agencia Nacional de Telecomunicações or ANATEL) auctioned the spectrum lots remaining in the 1800 MHz, 1900 MHz, 2500 MHz and 3500 MHz bands, where Telefónica acquired seven lots of 2.5 GHz frequency band. These lots are associated to six different States, five of them in the capital cities of the States of São Paulo, Rio de Janeiro, Porto Alegre, Florianápolis, and Palmas and one in an interior city of the State of Mato Grosso do Sul. Such frequencies will be used for provision of mobile broadband service on 4G.

Further to the above, certain administrations may not have announced their intention to release new spectrum and may do so during the year. The above does not include processes announced via general statements by administrations, which involve bands not key to Telefónica's needs. Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

Risks relating to concessions and licenses previously granted

In the state of São Paulo, Telefónica Brazil provides local and national long-distance Commuted Fixed Telephony Service ("CFTS") under the public regime, through a concession agreement, which will be in force until 2025. In accordance with current regulations, Telefónica Brazil informed ANATEL that the net value as of December 31, 2015 of assets assigned to the provision of the CFTS (which include, among others, switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment) were estimated to total 7,856 million Brazilian reais. In principle, the assets assigned to the provision of the CFTS are considered reversible assets; the scope of such reversibility is subject to a complex debate at different instances.

On June 27, 2014, as established in the concession agreement, ANATEL issued a public consultation for the revision of the concession agreement. Although definitive conditions (which might deal, among others, with the reversibility of assets, universalization goals and, in general, the obligational regime of the concessionaire) were to be published in 2015, such publication was postponed until April 2016. In addition, current reversibility regulations will be reviewed by ANATEL, which is expected to issue a public consultation in the near future. Definitive regulations might be issued in the second half of 2016. We cannot assure that changes made to the concession terms or to the reversibility regulations will not be detrimental to Telefónica's interests.

In Colombia, the ICT Ministry issued Resolution 597 on March 27, 2014, to renew 850 MHz/1900 MHz licenses for 10 additional years. The reversion of assets (other than radio frequencies, which is clear that must be returned) and its scope, has been discussed in the context of the liquidation of the concession contract, taking into consideration the terms of the contract, and the Constitutional Court's review of Law 422 of 1998, and Law 1341 of 2009. Discussions on the matter concluded on February 16, 2016. The ITC Ministry has announced that it is going to convene the Arbitral Tribunal, in accordance with what was agreed upon in the concession contract. To date, the content of the claim is unknown.

In Peru, the concessions for the provision of the fixed-line service will remain in force until November 2027. However, the Company filed a partial renewal request for five more years in December 2013. As of the date of this Annual Report, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) is still pending.

Telefónica Móviles Chile, S.A. was awarded spectrum on the 700 MHz (2x10 MHz) band in March 2014. The claim brought by a consumer organization against 700 MHz assignments was rejected by the Court of Defense of Free Competition in a judgment of July 24, 2015 and the appeal before the Hon. Supreme Court submitted by the consumer organization is still awaiting resolution.

In El Salvador, the process of renewal of the Group's licenses, which expires in 2018, has been postponed.

In Ecuador, once the Group's concession for mobile services expires in 2023, the renewal of such concession or the granting of a new concession will be subject to negotiation with the Government. If the Group fails to renew such concession or obtain a new concession, assets assigned to the provision of mobile services will revert to the State in exchange for a fee.

The Group's consolidated investment in spectrum acquisitions and renewals in 2015 amounted to 1,585 million euros.

The Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above or any others in which it operates or its inability to assume the related costs, could have an adverse impact on its ability to launch and provide new services and on Telefónica's ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and cash flows.

Regulation of wholesale and retail charges

The European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. Under this regulation, from April 30, 2016, when its implementation becomes effective, until June 15, 2017 operators may charge users roaming within the EU an additional fee on their domestic prices for roaming calls, SMS and data services, subject to certain regulated limits. In particular, the surcharges allowed during this period are 0.05 euro/minute for calls, 0.02 euro per SMS sent and 0.05 euro per megabits data (excluding VAT). During this period, the sum of the domestic retail price and any such surcharge shall not exceed 0.19 euro/minute for calls, 0.06 euro per SMS sent and 0.20 euro per megabits data. However, surcharges will not be permitted from June 15, 2017 onwards. The impact of this measure is very difficult to quantify because it will depend on the elasticity of traffic to decreases in the rates charged.

The decreases in wholesale mobile network termination rates (MTR) in Europe are also noteworthy. In the United Kingdom, wholesale MTRs have been reduced to 0.680 ppm (pence/minute) from May 1, 2015 (representing a 19.5% reduction compared to the previous rates). Further cuts of 26.3% and 3.1% (in real terms) will come into effect in April 1, 2016, and April 1, 2017, respectively. However, the impact of these decreases in the Group's results will be diminished if the proposed sale of our operations in the United Kingdom to Hutchison is completed on a timely basis.

In Germany, on April 24, 2015, BNetzA adopted its final decisions to reduce MTRs. The new prices will gradually decrease from 0.0172 euro/minute to 0.0166 euro/minute from December 1, 2015 until the end of November 2016. The European Commission had beforehand requested that the German regulator withdraw or amend the proposal of such decision. Because BNetzA did not apply the "Pure LRIC (Long Run Incremental Cost Model)" approach recommended by the European Commission, there is a risk that the Commission will initiate infringement proceedings against Germany, and rates may be further reduced.

In Spain, the Spanish National Markets and Competition Commission (Comisión Nacional de los Mercados y la Competencia or CNMC) has initiated the process of reviewing the prices of mobile termination, with a final decision expected to be adopted in the second half of 2016. Additionally, in May 2015, the CNMC launched a public consultation on the analysis of the market for access and call origination on fixed networks. The CNMC proposes to maintain the obligation of Telefónica to provide a wholesale interconnection offer (RIO) and a wholesale offer of access to the fixed telephone line (WLR), both with cost-oriented prices. The final decision is expected to be issued during the first half of 2016.

In Latin America, it is likely that MTRs are also reduced in the short to medium term. For example, in Mexico, on October 1, 2015, the IFT adopted the MTR for 2016. The MTR was set at 0.1869 Mexican pesos per minute in consistency with the Pure LRIC model. The previous MTR was set at 0.2505 pesos per minute.

Telefónica has appealed this decision as well as other decisions concerning the MTR applicable from 2011 to 2015.

In Brazil, ANATEL has been issuing ex-ante regulations to ensure competition in the wholesale market which includes reductions of the MTR. In this regard, the "Plano Geral de Metas de Competição (PGMC), as amended by Resolution 649/2015, established that mobile termination fees are subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees shall be in force (such Resolution has been challenged in courts without a definitive outcome).

In Argentina, the new legal framework "Argentina Digital" provides the new regulator the possibility to regulate the tariffs and prices of essential public services, wholesale services and those the regulator determines based on reasons of public interest, on which the law does not set parameters. As a result, there may be a negative impact, depending on how the new regulator exercises its powers. In addition, until the Secretary of Communications determines that there is effective competition for telecommunications services, the "dominant" providers in the relevant areas (which include Telefónica de Argentina) must respect the maximum tariffs established in the general tariff structure.

Regulation of Universal Services

In September 2015, as a part of the DSM Strategy, the European Commission issued a public consultation on the review of the regulatory framework for electronic communications, including certain aspects of the Universal Service obligations. Depending on the outcome of this public consultation, the European Commission could initiate a legislative process including both the potential inclusion of certain broadband speeds in its scope and a possible reduction of some of the current Universal Service obligations that are becoming obsolete. Depending on the terms that will be set forth in the new regulation, implementation at a local level could lead to higher costs for both the Universal Service provider and the operators forced to finance the Universal Service.

In Spain, the licenses of Telefónica de España and Telefónica Telecomunicaciones Públicas (which owns public terminals) for the provision of Universal Services will expire on December 31, 2016. As from this date, there will be a new tender for the award of the provision of the Universal Services.

Regulation of fiber networks

On November 18, 2015 the Spanish CNMC adopted a Draft Resolution on the wholesale broadband market regulation, which foresees a geographical segmentation in competitive and non-competitive areas. This draft Resolution was approved by the European Commission on December 18, 2015. The new resulting regulation, which will apply to NGA (Next Generation Access Networks), could be approved in the first quarter of 2016 and will presumably last for at least three years. Its implementation is expected to result in an increase, of the current regulatory obligations of Telefónica in Spain, in terms of its granting of access to other operators to its fiber network and with respect to certain aspects relating specifically to the business segment.

Regulations on privacy

In Europe, a political agreement between the Council and the European Parliament was reached on December 15, 2015, on the new General Data Protection Regulation (GDPR) and the Data Protection Directive. Formal adoption of such regulation by both the Council and the Parliament is expected to take place in spring 2016. The GDPR would become effective two years thereafter, by spring 2018. Some of the critical provisions of this new Regulation will make tougher the launch of new services focused on the processing of personal data. In addition, the GDPR will introduce administrative fines of up to 4% of an undertaking's annual global turnover for breaching the new data protection rules.

In October 2015, the Court of Justice of the European Union declared invalid the Decision of the European Commission[2] of July 26, 2002, known as the "Safe Harbor Agreement", relating to the transfer of personal data from the EU to the United States. Since November 2015, EU and US Authorities have been negotiating a new agreement that ensures a level of protection similar to that provided by the EU. Failure to reach this agreement would create difficulties in the provision of services which involve the flow of EU citizens' personal data to the US.

[2] Commission Decision 2000/520/EC, of 26 July 2000 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequacy of the protection provided by the safe harbour privacy principles and related frequently asked questions issued by the US Department of Commerce.

In Brazil, it is expected, in the near future, that the Personal Data Protection Act will be adopted. This could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment. In Peru, on May 8, 2015, the new Personal Data Protection Law came into force. The adoption of secondary legislation is still pending. In Ecuador, the Telecommunications Act (Ley Orgánica de Telecomunicaciones), adopted in February 2015, devotes a whole chapter to regulate the use of personal data.

Regulation of functional separation

The principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operates could result in greater regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators (in specific cases and under exceptional conditions) forcing operators with significant market power and vertically-integrated operators to separate their wholesale and retail businesses at a functional level. They would therefore be required to offer equal wholesale terms to third-party operators that acquire these products.

Regulation of network neutrality[3]

As mentioned above, the European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. The regulation will enter into force on April 30, 2016. The application of the Regulation could directly affect possible future business models of Telefónica and may affect the network management or differentiation of characteristics and quality of Internet access service.

Telefónica operates in Latin American countries where net neutrality has already been ruled, such as Chile, Colombia, Brazil, Argentina, Mexico and Peru, where Osiptel published on September 8, 2015 the Draft Regulation on Net Neutrality. In Brazil, the Secretariat of Legislative Matters of the Ministry of Justice is concluding a proposal on Net Neutrality Regulation.

If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to various anti-corruption laws, including the U.S. Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanction programs, including those administered by the United Nations, the European Union and the United States, including the U.S. Treasury Department's Office of Foreign Assets Control. The anti-corruption laws generally prohibit providing anything of value to government officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group's business, it may deal with entities, the employees of which are considered government officials. In addition, economic sanctions programs restrict the Group's business dealings with certain sanctioned countries, individuals and entities.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption laws and sanctions regulations could lead to financial penalties, exclusion from government contracts, damage to our reputation and other consequences that could have a material adverse effect on the Group's business, results of operations and financial condition.

As at the date of this report, Telefónica is currently conducting an internal investigation regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about this matter and intends to cooperate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

[3] In general terms, it is a principle applicable to the field of Internet networks, for which operators may not place restrictions on the terminals that can be connected or the services, applications and content that can be distributed. It also refers to non-discrimination by operators between different types of traffic circulating through their networks.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

The Company may not be able to adequately foresee and respond to technological changes and sector trends.

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

New products and technologies arise constantly, and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 1,012 million euros in 2015, representing a decrease of 0.9% from 1,021 million euros in 2014 (959 million euros in 2013). These expenses represented 2.1%, 2.3% and 1.9% of the Group's consolidated revenues in 2015, 2014 and 2013, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development (OECD) manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 100MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond the Company's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency.

The Company depends on its suppliers.

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets, with a high concentration in a small number of suppliers, poses risks that may affect the Company's operations, and may cause legal contingencies or damages to the Company's image in the event that inappropriate practices are produced by a participant in the supply chain.

As of December 31, 2015, the Telefónica Group depended on five handset suppliers and 13 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

Unanticipated network interruptions can lead to quality loss or the interruption of the service.

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses become increasingly dependent on telecommunications and computer networks and adopt cloud computing technologies. Cybersecurity threats include gaining unauthorized access to our systems or inserting computer viruses or malicious software in our systems to misappropriate consumer data and other sensitive information, corrupt our data or disrupt our operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, portable data devices and mobile phones and intelligence gathering on employees with access.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization (WHO), that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee (ICNIRP) have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may negatively affect the business, financial conditions, results of operations and cash flows of the Telefónica Group.

Possible regulatory, business, economic or political changes could lead to asset impairment.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairment in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. For example, with respect to the investment in Telco, S.p.A. (Telco), value adjustments were made in 2014 with a negative impact of 464 million euros.

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

Any of the foregoing could have an adverse impact on the business, financial position, results of operations and cash flows of the Group.

Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings.

Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and cash flows. In particular, the Telefónica Group is party to certain judicial tax proceedings in Peru concerning the clearance of certain previous years' income tax, in respect of which a contentious-administrative appeal is currently pending and to certain tax proceedings in Brazil, primarily relating to the CIMS (a Brazilian tax on telecommunication services). Further details on these matters are provided in Notes 17 and 20 of the Financial Statements.

Trend evolution

Telefónica is one of the world's leading mobile and fixed communications services providers, with a strategy focused on becoming a leader in digital communications to support future growth.

In 2015, Telefónica made progress towards long-term profitable and sustainable growth, improving its competitive position in key markets, increasing efficiencies and capturing synergies from the integrated approach of its business, processes and technologies. During recent years, the Company has taken several steps designed to transform its business, which have affected 2015 results:

- First, Telefónica has developed new business models based on mobile data centric proposals, bundled services, including converged fixed and mobile services, and digital capacities as part of a group-wide digital transformation drive to address changing consumption habits. A key component of this effort has been the increased investments in fiber and Long Term Evolution technology, which Telefónica believes will allow it to further monetize data and digital services. In this regard, Telefónica has significantly increased its number of data-driven accesses, including 78.0 million new smartphone accesses, 4.9 million new Pay TV accesses and 5.7 million new fiber accesses during the 2013-2015 period, to more than offset declining revenues and thereby increased average revenue per access year-on-year by 1.9% over the period.

- Second, changing consumption habits have resulted in reduced demand for fixed voice and mobile voice services and increased demand for mobile data services, such as watching videos and internet browsing on a smartphone, which finally in 2015 has been at a sufficient pace to offset in most of our markets the decline in fixed and mobile voice revenues (excluding declines due to changes in regulation) and start to show a positive trend.

- Third, Telefónica has strengthened its competitive position through a strategy of active portfolio management and in-market consolidation in key markets like Germany (with the acquisition of the E-Plus Group), Brazil (with the acquisition of GVT) and Spain (with the acquisition of DTS). These strategic acquisitions in core markets, coupled with recent divestments in non-core markets, have already allowed Telefónica to capture significant synergies.

- Finally, Telefónica has launched a simplification program designed to enable growth and transformation across its businesses; capture Group-wide synergies; simplify its commercial offerings (as it has done with the launch of "Movistar Fusión" bundle packages in Spain); modernize its information technology ("IT") network and global processes (through increased IT investment and commercial and customer care cost-reduction efforts); and improve its channels by increasing back-office efficiency. As part of this program, Telefónica has also sought to boost efficiency by increasing its outsourcing of support functions.

Telefónica has taken these steps against a backdrop of several broad trends and developments affecting Telefónica in recent years which have contributed to a downward trend in certain key performance indicators during the 2013-2015 period.

- First, changes in foreign exchange rates, particularly during 2014 and 2015 with the depreciation of the Brazilian real against the euro and the effects of the depreciation of the Venezuelan bolivar, have affected Telefónica's revenue growth.

- Second, inflation rates have increased Telefonica's expenses in many of our markets and we have not been able to increase our revenues at the same pace.

- Third, after a period of significant expansion, Telefónica has generally reduced the scope of its activities and exited certain countries in recent years to reduce its level of indebtedness and strengthen Telefónica's capacity for future growth.

- Fourth, Telefónica's business is highly regulated, which affects its revenues and imposes costs on its operations. For example, regulation sets the fixed rates that Telefónica charges for calls received from other companies' networks, and regulators have progressively lowered these rates in recent years.

- In addition, weak economic conditions in Europe generally, and in Spain in particular, have been a key driver of revenue trends in recent years, leading to a reduced demand for many of Telefónica's products and services, and the same trend is beginning to emerge in Latin America.

These trends and developments have contributed to a general downward trend in certain of Telefónica's key performance indicators during the 2013-2015 period, with revenues decreasing by 6.6% to 47,219 million euros for the year ended December 31, 2015 from 50,547 million euros for the year ended December 31, 2013 and operating income, profit for the year and net cash from operating activities decreasing during this period by 67.6%, 40.2% and 5.1%, respectively.

Nevertheless, we believe that Telefónica is positioned to benefit from the return to GDP growth in Europe, which began in 2014, as well as the potential implementation of the European Commission's recently announced Digital Single Market package of legislative measures, as we believe Telefónica is prepared to thrive in a policy environment that supports innovation and investment for the benefits of end users.

Events after the reporting period

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

Financing

On February 2, 2016, Telefónica Emisiones, S.A.U. redeemed 1,750 million euros of its notes, issued on February 2, 2006. The notes were guaranteed by Telefónica, S.A.

On February 3, 2016, Telefónica Emisiones, S.A.U. redeemed 802 million euros of its notes, issued on November 3, 2011 for an amount of 1,000 million euros. The notes were guaranteed by Telefónica, S.A.

On February 16, 2016, Telefónica Emisiones, S.A.U. redeemed 1,250 million U.S. dollars of its notes, issued on February 16, 2011. The notes were guaranteed by Telefónica, S.A.

Telefónica, S.A. agreed its 12 months extension option on the 2,500 million euros syndicated credit facility dated February 19, 2015 up to 2021 and on the 3,000 million euros syndicated credit facility dated February 18, 2014 up to 2020. This arrangement entered into effect on February 19, 2016.

Creation of a global telecommunications infrastructures company

On February 10, 2016, Telefónica announced the creation of Telxius, a company which will bring together certain infrastructure assets of the Group, which will enable the management of the Telefónica Group's infrastructure on a global scale with a more specialised and focused approach, with the aim of increasing the services provided to other operators, improving the return on capital invested and allowing Telxius to participate more actively in the growth opportunities that exist in the industry, including the possibility of incorporating third party assets.

Annual Corporate Governance Report for Listed Companies

A. Ownership structure

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

Date of last modification	Share capital (€)	Number of shares	Number of voting rights
2015/12/10	4,975,199,197.00	4,975,199,197	4,975,199,197

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

No

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

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	302,205,736	0	6.07%
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	0	249,501,612	5.01%
Blackrock, Inc.	0	177,257,649	3.56%

Name or corporate name of indirect holder	Through: Name or corporate name of direct holder	Number of voting rights
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Caixabank, S.A.	249,482,489
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Vidacaixa, S.A. de Seguros y Reaseguros	19,123
Blackrock, Inc	Blackrock Investment Management (UK)	177,257,649

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

Name or corporate name of shareholder	Date of transaction	Description of transaction
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A.3. Complete the following tables on company directors holding voting rights through company shares.

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Mr. César Alierta Izuel	5,293,554	0	0.11%
Mr. Isidro Fainé Casas	572,483	0	0.01%

Mr. José María Abril Pérez	134,886	152,124	0.01%
Mr. Julio Linares López	462,393	2,115	0.01%
Mr. José María Álvarez-Pallete López	553,208	0	0.01%
Mr. José Fernando de Almansa Moreno-Barreda	20,397	0	0.00%
Ms. Eva Castillo Sanz	109,225	0	0.00%
Mr. Carlos Colomer Casellas	49,377	68,260	0.00%
Mr. Peter Erskine	79,963	0	0.00%
Mr. Santiago Fernández Valbuena	217,554	0	0.00%
Mr. Alfonso Ferrari Herrero	659,520	21,937	0.01%
Mr. Luiz Fernando Furlán	36,945	0	0.00%
Mr. Gonzalo Hinojosa Fernández de Angulo	49,128	198,862	0.00%
Mr. Pablo Isla Álvarez de Tejera	9,889	0	0.00%
Mr. Antonio Massanell Lavilla	2,638	0	0.00%
Mr. Ignacio Moreno Martínez	17,606	0	0.00%
Mr. Francisco Javier de Paz Mancho	62,368	0	0.00%

Name or corporate name of indirect shareholder	Through: Name or corporate name of direct shareholder	Number of voting rights
Mr. José María Abril Pérez	Other company shareholders	152,124
Mr. Julio Linares López	Other company shareholders	2,115
Mr. Carlos Colomer Casellas	Other company shareholders	68,260
Mr. Alfonso Ferrari Herrero	Other company shareholders	21,937
Mr. Gonzalo Hinojosa Fernández de Angulo	Other company shareholders	198,862

% of total voting rights held by the Board of Directors
0.17%

Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	Equivalent number of shares	% of total voting rights
Mr. César Alierta Izuel	972,000	0	1,518,750	0.02%
Mr. José María Álvarez-Pallete López	576,000	0	900,000	0.01%

Mr. Santiago Fernández Valbuena	708,000	0	825,000	0.01%

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

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

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Banco Bilbao Vizcaya Argentaria, S.A. (or any of the companies of its Group), together with Telefónica, S.A. and with Caixabank, S.A., in Telefónica Factoring España, S.A., TFP, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Compañía de Cartera de Inversiones, S.A. (a company which belongs to Grupo BBVA), together with Telefónica Compras Electrónicas, S.A.U., in Adquira España, S.A.
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Corporate	Shareholding of Caixabank, S.A., with Telefónica, S.A. and with Banco Bilbao Vizcaya Argentaria, S.A. (or with any of the companies of its Group), in Telefónica Factoring España, S.A., TFP, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Corporate	Shareholding of Finconsum, Establecimiento Financiero de Crédito, S.A.U. (subsidiary of CaixaBank, S.A.), together with Telefónica, S.A., in Telefónica Consumer Finance, Establecimiento Financiero de Crédito, S.A.
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Corporate	Joint shareholding of Caixa Card 1 Establecimiento Financiero de Crédito, S.A.U., with Telefónica Digital España, S.L. and with Banco Santander, S.A., in Yaap Digital Services, S.L.

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

Yes

Parties to the shareholders' agreement

Telefónica, S.A.
China Unicom (Hong Kong) Limited

% of share capital affected
1.29%

Brief description of the agreement:

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

Parties to the shareholders’ agreement
Telefónica, S.A.
Vivendi, S.A.

% of share capital affected
0.95%

Brief description of the agreement:

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

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

No

Shareholders involved in concerted action	% of share capital affected	Brief description of the concerted action
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Expressly indicate any amendments to or termination of such agreements or concerted actions during the year.

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

No

Name or corporate name
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Remarks

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

At year end:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
141,639,159	0	2.85%

(*) Through:

Name or corporate name of direct shareholder	Number of shares held directly
--	--
Total	

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

Explain any significant changes

On January 7, 2015 it was notified the Comisión Nacional del Mercado de Valores (CNMV) the direct acquisition of 51,798,609 shares were, accounting for 1.112% of the company's share capital.

On July 16, 2015, it was notified the CNMV the direct acquisition of 49,891,005 shares, accounting for 1.010% of the company's share capital.

On October 19, 2015, it was notified the CNMV the direct acquisition of 51,133,215 shares were, accounting for 1.051% of the company's share capital.

Furthermore, in accordance with the resolution for reduction in share capital through the cancellation of treasury shares approved by the Ordinary General Shareholders Meeting of Telefónica, S.A. on June 12, 2015, and after the resolution to that effect adopted by the Board of Directors of the Company, the reduction of share capital document was registered in the Companies Registry of Madrid on July 24, 2015. Consequently, 74,076,263 treasury shares of Telefónica, S.A., which represented 1.50% of its share capital, were cancelled.

Likewise, on July 29, 2015, Telefónica, S.A. entered into an agreement with Vivendi, S.A. through which Telefónica committed to deliver 46.0 million of its treasury shares, representing 0.95% of its share capital, in exchange for 58.4 million of preferred shares of Telefônica Brasil, S.A, (received by Vivendi, S.A. in the context of the acquisition of GVT Participaçoes, S.A.) representing approximately 3.5% of the share capital of Telefônica Brasil, S.A. On September 16, 2015 the aforementioned 46.0 million treasury shares were delivered.

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

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

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

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

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

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

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

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

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

Estimated free-float capital	%
	80.10

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

Yes

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

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

No

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

--

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

Yes

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

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

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

B. General Shareholders Meeting

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

No

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

No

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

--

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

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

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

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

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

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

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

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

Date of general meeting	Attendance data				
			% remote voting		
	% attending in person	% by proxy	Electronic means	Other	Total
2014/05/30	5.66%	48.65%	0.01%	0.48%	54.80%
2015/06/12	11.55%	46.36%	0.01%	0.48%	58.40%

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

Yes

Number of shares required to attend the General Shareholders Meetings
300

B.6. Section eliminated.

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

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

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

C. Company management structure

C.1. Board of Directors

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

Maximum number of directors	20
Minimum number of directors	5

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

Name or corporate name of director	Represen-tative	Type of director	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. César Alierta Izuel	-	Executive	Chairman	1997/01/29	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Julio Linares López	-	Other external directors	Vice Chairman	2005/12/21	2011/05/18	Resolution of General Shareholders Meeting
Mr. José María Abril Pérez	-	Proprietary	Vice Chairman	2007/07/25	2013/05/31	Resolution of General Shareholders Meeting
Mr. Isidro Fainé Casas	-	Proprietary	Vice Chairman	1994/01/26	2011/05/18	Resolution of General Shareholders' Meeting
Mr. José María Álvarez-Pallete López	-	Executive	Chief Operating Officer	2006/07/26	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Peter Erskine	-	Independent	Director	2006/01/25	2011/05/18	Resolution of General Shareholders' Meeting
Ms. Eva Castillo Sanz		Other external directors	Director	2008/01/23	2013/05/31	Resolution of General Shareholders Meeting
Mr. Luiz Fernando Furlán	-	Independent	Director	2008/01/23	2013/05/31	Resolution of General Shareholders Meeting
Mr. Wang Xiaochu	-	Proprietary	Director	2015/09/30	2015/09/30	Co-option
Mr. José Fernando de Almansa Moreno-Barreda	-	Other external directors	Director	2003/02/26	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo	-	Independent	Director	2002/04/12	2012/05/14	Resolution of General Shareholders' Meeting
Mr. Carlos Colomer Casellas	-	Independent	Director	2001/03/28	2011/05/18	Resolution of General Shareholders' Meeting
Mr. Antonio Massanell Lavilla	-	Proprietary	Director	1995/04/21	2011/05/18	Resolution of General Shareholders' Meeting
Mr. Pablo Isla Álvarez de Tejera	-	Independent	Director	2002/04/12	2012/05/14	Resolution of General Shareholders Meeting
Mr. Ignacio Moreno Martínez	-	Proprietary	Director	2011/12/14	2012/05/14	Resolution of General Shareholders Meeting
Mr. Santiago Fernández Valbuena	-	Executive	Director	2012/09/17	2013/05/31	Resolution of General Shareholders Meeting
Mr. Alfonso Ferrari Herrero	-	Independent	Director	2001/03/28	2011/05/18	Resolution of General Shareholders Meeting
Mr. Francisco Javier de Paz Mancho	-	Independent	Director	2007/12/19	2013/05/31	Resolution of General Shareholders' Meeting

Total number of directors
18

Indicate any board members who left during this period.

Name or corporate name of director	Type of directorship at time of leaving	Leaving date
Mr. Chang Xiaobing	Proprietary	2015/08/24

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

EXECUTIVE DIRECTORS

Name or corporate name of director	Post held in the company
Mr. César Alierta Izuel	Executive Chairman
Mr. José María Álvarez-Pallete López	Chief Operating Officer (C.O.O.)
Mr. Santiago Fernández Valbuena	General Manager

Total number of executive directors	3
% of the board	16.67%

EXTERNAL PROPRIETARY DIRECTORS

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

Total number of proprietary directors	5
% of the board	27.78%

INDEPENDENT EXTERNAL DIRECTORS

Name or corporate name of director	Profile
Mr. Alfonso Ferrari Herrero	Industrial Engineer. Formerly Executive Chairman of Beta Capital, S.A. and senior manager at Banco Urquijo.
Mr. Francisco Javier de Paz Mancho	Graduate in Information and Advertising. Law Studies. IESE Business Management Program. Formerly Chairman of the State-owned company MERCASA.
Mr. Gonzalo Hinojosa Fernández de Angulo	Industrial Engineer. Formerly Chairman and CEO of Cortefiel Group.
Mr. Carlos Colomer Casellas	Graduate in Economics. Was Chairman of the Colomer Group until 2013
Mr. Pablo Isla Álvarez de Tejera	Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A.
Mr. Peter Erskine	Psychology Graduate. Was General manager of Telefónica Europe until 2007. Was Chairman of Ladbrokes, Plc until December 2015.
Mr. Luiz Fernando Furlán	Degrees in chemical engineering and business administration, specialising in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.

Total number of independent directors	7
% of the board	38.89%

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

Yes

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

Name or corporate name of director	Description of the relationship	Reasons
Mr. Carlos Colomer Casellas	Mr. Carlos Colomer Casellas is an independent Director of Abertis Infraestructuras, S.A., the parent company of Grupo Abertis, which has engaged in certain operations with the Telefónica Group (sale and leasing of mobile telephony towers) described in further depth in section H "Other Information of Interest" (Note 18 of section D. 5)	In the opinion of the Board of Directors of Telefónica, S.A., the operations referred to above are not likely to compromise the independence of Mr. Colomer Casellas in any way, bearing in mind: (i) the nature of the transactions, which, because of their purpose and special characteristics, are unlikely to exert any influence by one party upon another, (ii) their amount, which is not significant, both from the standpoint of Telefónica and Abertis, and (iii) the fact that Mr. Colomer Casellas is an Independent Director in Abertis Infraestructuras, S.A.

OTHER EXTERNAL DIRECTORS

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

Name or corporate name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained
Mr. Julio Linares López	On September 17, 2012, Mr. Julio Linares López resigned from his post as COO of Telefónica, S.A. and his managerial post in the Telefónica Group and therefore went from being an Executive Director to being classified in the "Other External Directors" category.	Telefónica, S.A.
Ms. Eva Castillo Sanz	On February 26, 2014, Ms. Eva Castillo Sanz resigned as Chairwoman of Telefónica Europa, and was therefore included in the "Other external Directors" category.	Telefónica, S.A.
Mr. José Fernando de Almansa Moreno-Barreda	On March 25, 2015, the Board of Directors of Telefónica, S.A., having considered an analysis performed by the Nominating, Compensation and Corporate Governance Committee, resolved that the category of the Director M. José Fernando de Almansa Moreno-Barreda, be modified from Independent to "Other External Directors", since he had been appointed as a Director of Telefónica, S.A. more than 12 years ago.	Telefónica, S.A.

Total number of other external directors	3
% of the board	16.67%

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

Name or corporate name of director	Date of change	Former category	Current category
Mr. José Fernando de Almansa Moreno-Barreda	2015/03/25	Independent	Other External

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

	Number of female directors				% of total directors of each type			
	Year 2015	Year 2014	Year 2013	Year 2012	Year 2015	Year 2014	Year 2013	Year 2012
Executive	0	0	1	1	0.00%	0.00%	25.00%	25.00%
Proprietary	0	0	0	0	0.00%	0.00%	0.00%	0.00%
Independent	0	0	0	0	0.00%	0.00%	0.00%	0.00%
Other External	1	1	0	0	33.33%	50.00%	0.00%	0.00%
Total:	1	1	1	1	5.56%	5.56%	5.56%	5.56%

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

Explanation of measures

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Explanation of measures

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

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

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

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

Explanation of the reasons.

All the measures and processes agreed and adopted by the Board of Directors and the Nominating, Compensation and Corporate Governance Committee to ensure the number of female directors on the Board guarantee an even balance and to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors have been implemented and initiated by the Company. In 2015, the only change in the composition of the Board of Directors was the appointment of Mr. Wang Xiaochu, as indicated in section C.1.9. of this Report.

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

Explanation of conclusions

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

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

Since the policy was approved and until December 31, 2015, the date of reference of this report, no vacancy has arisen in the Board of Directors, and hence from the standpoint of Director selection, the policy has not been put into practice.

Notwithstanding the above, the criteria set out in the aforementioned Director Selection Policy, which were already included, in general, in the Regulation of the Board of Directors, were taken into account in the appointment by co-option of the Director Mr. Wang Xiaochu. Mr. Xiaochu's appointment received a favourable report from the Nominating, Compensation and Corporate Governance Committee.

Notwithstanding the foregoing, with regard to the promotion of Female Directors' presence in the Board of Directors, it is important to note that the policy expressly states that it is mandatory for Director selection procedures to encourage gender diversity, and forbids any type of underlying bias which might cause any form of discrimination.

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

As stated in section C.1.3 of this Annual Corporate Governance Report, at December 31, 2015, the group of external Directors of Telefónica, S.A. was composed of 15 members (out of a total of 18 Members), of whom five are proprietary Directors, seven are independent and three fall under the "Other external Directors" category.

Of the five proprietary directors, two act in representation of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona,"la Caixa", which holds 5.01 % of the capital stock of Telefónica, S.A., and two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.07% of the capital; and one in representation of China Unicom (Hong Kong) Limited (China Unicom), which owns 1.29% of the capital stock. The percentages mentioned above refer to December 31, 2015.

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

Name or corporate name of shareholder	Reasons

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

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

No

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

Yes

Name of director	Reasons for resignation
Mr. Chang Xiaobing	In a statement dated August 31, 2015, Mr. Chang Xiaobing stated that he was stepping down from his duties as Director of Telefónica, S.A. effectively from August 24, 2015. Mr. Xiaobing resigned as a member of the Board of Directors due to the change in the organisational structure which took place in Grupo China Unicom, with Mr. Chang Xiaobing's ensuing resignation from the positions of Chairman and CEO of China Unicom (Hong Kong) Limited, and the appointment of Mr. Wang Xiaochu to fill his place.

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

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

Mr. José María Álvarez-Pallete López – Chief Operating Officer	The Chief Operating Officer (COO) has been delegated those powers of the Board of Directors related to the management of the business and the performance of the highest executive functions over all the Company's business areas, except those which cannot be delegated by Law, under the Corporate Bylaws or according to the Regulations of the Board of Directors.

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

Name or corporate name of director	Corporate name of the group company	Position	Doers he or she have executive functions?
Mr. Alfonso Ferrari Herrero	Telefónica del Perú, S.A.A.	Director	No
	Telefónica Chile, S.A.	Acting Director	No
Mr. Francisco Javier de Paz Mancho	Telefónica de Argentina, S.A.	Director	No
	Telefônica Brasil, S.A.	Director	No
	Telefónica Gestión de Servicios Compartidos, S.A.	Chairman	No
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director	No
Mr. José Fernando de Almansa Moreno-Barreda	Telefônica Brasil, S.A.	Director	No
	Telefónica Móviles México, S.A. de C.V.	Director	No
Mr. Luiz Fernando Furlán	Telefônica Brasil, S.A.	Director	No
Ms. Eva Castillo Sanz	Telefónica Deutschland Holding, A.G.	Chairman of Supervisory Board	No
Mr. Santiago Fernández Valbuena	Colombia Telecomunicaciones, S.A. E.S.P.	Director	No
	Telefónica América, S.A.	Chairman	No
	Telefônica Brasil, S.A.	Vice Chairman	No
	Telefónica Capital, S.A.	Sole Director	No
	Telefónica Internacional, S.A.U.	Chairman	
	Telefónica Móviles México, S.A. de C.V.	Vice Chairman	No
	SP Telecomunicaçoes Ltda.	Chairman	No
	Telefónica Chile, S.A.	Acting Director	No

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

Name or corporate name of director	Name of listed company	Position
Mr. César Alierta Izuel	China Unicom (Hong Kong) Limited	Director
	International Consolidated Airlines Group, S.A. ("IAG")	Director
Mr. Isidro Fainé Casas	Banco Portugués de Investimento, S.A. (BPI)	Director
	The Bank of East Asia	Director
	Gas Natural SDG, S.A.	Director
	Repsol, S.A.	First Vice Chairman
	Caixabank, S.A.	Chairman
	Suez Environnement Company	Director
	Abertis Infraestructuras, S.A.	Director

Mr. Carlos Colomer Casellas	Inversiones Mobiliarias Urquiola, S.A. SICAV	Chairman
	Ahorro Bursatil, S.A. SICAV	Chairman
Ms. Eva Castillo Sanz	Bankia, S.A.	Director
Mr. Pablo Isla Alvarez de Tejera	Inditex, S.A.	Chairman- CEO
Mr. Luiz Fernando Furlán	Brasil Foods, S.A. (BRF)	Director
	AGCO Corporation	Director
Mr. Ignacio Moreno Martínez	Secuoya, Grupo de Comunicación, S.A.	Director
Mr. Santiago Fernández Valbuena	Ferrovial, S.A.	Director

Mr. Antonio Massanell Lavilla	Caixabank, S.A.	Vice Chairman
	Erste Group Banck	Director
Mr. Wang Xiaochu	China United Network Communications Limited	Chairman
	China Unicom (Hong Kong) Limited	Chairman and CEO
Mr. José Fernando de Almansa Moreno-Barreda	Laboratorios Farmacéuticos Rovi, S.A.	Director

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

Yes

Explanation of rules
As set forth in Article 28.2 of the Regulations of the Board of Directors, the Directors will devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors. In this regard, persons who belong to over five Board of Directors of other corporations other than Telefónica, S.A. and its Group companies cannot be appointed as Directors. For these purposes, a) all the Boards of companies which form part of the same Group will be counted as a single Board; and b) Boards of asset-holding companies or companies which are vehicles or complements for the Director's own professional activity, of his/her spouse or person with an analogous affective relationship, or his/her closest relatives, will not be counted. On an exceptional basis, for justified reasons, the Board will be able to exempt the Director from this prohibition.

C.1.14 Section eliminated.

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

Board remuneration (thousands of euros)	23,611
Amount of total remuneration by current directors in accumulated pension rights (thousands of euros)	1,435
Amount of total remuneration by former directors in accumulated pension rights (thousands of euros)	269

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

Name or corporate name	Position(s)
Mr. Ignacio Cuesta Martín-Gil	Director, Internal Audit

Mr. Ramiro Sánchez de Lerín García-Ovies	General Secretary and of the Board of Directors
Ángel Vilá Boix	General Manager of Strategy and Finance
Mr. Guillermo Ansaldo Lutz	General Manager of Global Resources
Mr. Eduardo Navarro de Carvalho	Chief Commercial Digital Officer (CCDO)

Total remuneration received by senior management (in thousands of euros)
9,345

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

Name or corporate name of director	Name or corporate name of significant shareholder	Position
		Chairman of Criteria Caixa, S.A.U.
		Chairman of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"
Mr. Isidro Fainé Casas	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Chairman of Caixabank, S.A.
		Vice-Chairman of Caixabank, S.A.
		Non-Executive Chairman of Cecabank, S.A.
		Member of Supervisory Board of Erste Group Bank
		Director of Sociedad de Gestión de Activos procedentes de la Restructuración Bancaria (SAREB)
Mr. Antonio Massanell Lavilla	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Director of Mediterranea Beach & Golf Community, S.A.
		Acting Director of Grupo Financiero BBVA Bancomer, S.A. de C.V.
Mr. José Fernando de Almansa Moreno-Barreda	Banco Bilbao Vizcaya Argentaria, S.A.	Acting Director of BBVA Bancomer, S.A.

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

Name or company name of director with relationship	Name or company name of significant shareholder with relationship	Description of relationship
Mr. César Alierta Izuel	Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"	Patron of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa"
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Early retirement. Formerly General manager of Wholesale and Investment Banking
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office

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

Yes

Outline of changes
See heading H “Other information of interest”, Note 11 to Section C.1.18

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

See heading H “Other information of interest”, Note 12 to Section C.1.19

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

Outline of changes

In a meeting on February 18, 2015 the Nominating, Compensation and Corporate Governance Committee revised and analysed the results of the Directors of Telefónica, S.A.'s evaluation in 2014 of the Board of Directors and its Committees and of the Company's General Meeting, concluding that, on the whole, they were highly satisfied with the organisation and activities of these governing bodies.

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

i) Whenever possible, the documentation and the information about the matters to be addressed in the meetings of the Board of Directors should be submitted further in advance.

ii) To continue mediating all the possible channels in order to ensure that the General Shareholders Meeting is conducted in the best possible way.

iii) Identify and coordinate matters which have to be addressed by each one of the Board Committees, so as to prevent repetitions and overlaps.

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

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

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

In the Board of Directors meeting held on 16 December, all the Directors were handed a questionnaire in order to carry out the assessment for 2015.

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

- Composition (quantitative and qualitative), working and powers of the Board, expressly including adequate performance and the Directors' contribution to the Board of Directors.

- Composition and working of the Committees, expressly including the performance and contribution of the Chairpersons of the Board of Directors' Committees.
- Performance of Senior Management, expressly including the adequacy of the performance of the Executive Chairman and the Chief Operating Officer (C.O.O.).
- Directors' Rights and Duties.
- General Shareholders Meeting.

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

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

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

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

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

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

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

b) When they are affected by any of the cases of incompatibility or prohibition established by Law.

c) When they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for having failed to fulfil any of their obligations as Directors.

d) When their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardise its interests.

The conditions listed above under Recommendation C.1.19 “Removal” above must also be taken into consideration.

C.1.22 Section eliminated.

C.1.23. Are qualified majorities, other than legal majorities, required for any type of decisions?

No

If applicable, describe the differences.

Description of differences

C.1.24 Indicate whether there are any specific requirements, apart from those relating to the directors, to be appointed Chairman of the Board of Directors.

Yes

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

C.1.25. Indicate whether the Chairman has the casting vote.

No

C.1.26. Indicate whether the Bylaws or the regulations of the Board of Directors set any age limit for directors.

No

C.1.27. Indicate whether the Bylaws or the regulations of the Board of Directors set a limited term of office for independent directors.

No

C.1.28 Indicate whether the Bylaws or board regulations stipulate specific rules on appointing a proxy to the board, the procedures thereof and, in particular, the maximum number of proxy appointments a director may hold. Also provide details if any restriction in the categories in which a proxy may be delegated has been established, beyond the restrictions imposed by applicable legislation. If so, give brief details.

In accordance with Article 19 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavour to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Non-executive Directors may only delegate their proxy in another non-executive Director. Such proxies may be granted by letter or any other means that, in the Chairman's opinion, ensures the certainty and validity of the proxy granted.

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

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

Number of board meetings	15
Number of Board meetings held without the Chairman's attendance	0

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

Number of meetings	0

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

Executive Commission	18
Audit and Control Committee	13
Nominating, Compensation and Corporate Governance Committee	11
Regulation Committee	4
Service Quality and Customer Service Committee	4
Institutional Affairs Committee	11
Strategy Committee	11
Innovation Committee	11

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

Directors' attendance	14
% of attendances of the total votes cast during the year	99.63%

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

No

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

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

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

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

a) Supervise internal audit and, in particular:

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

   b) Propose the selection, appointment and removal of the person responsible for internal audit;

   c) Propose the budget for such service;

   d) Review the internal audit work plan and its annual activities report;

   e) Receive regular information on its activities; and

   f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.

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

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

   a. The types of risk (operational, technological, financial, legal and reputational) facing the Company;

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

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

d) Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardise the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

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

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

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

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

   1. The financial information that the Company must periodically disclose;

   2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and

   3. Related party transactions.

The Audit and Control Committee verifies both the periodical financial information and the Annual Financial Statements, ensuring that all financial information is drawn up according to the same professional principles and practices. To this effect, the Audit and Control Committee meets whenever appropriate, having held thirteen (13) meetings in the course of 2015.

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

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

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

No

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

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

C. 1.34 Section eliminated.

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

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

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

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

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

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

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

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

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

No

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

No

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

No

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

No

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

	Company	Group
Number of consecutive years	11	11
	Company	Group
Number of years audited by current audit firm/Number of years the company's financial statements have been audited (%)	33.3	44.0

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

Yes

Procedures

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

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

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

Yes

Procedures

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

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

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

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

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

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

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

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

Yes

Details of rules

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

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

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

No

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

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

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

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

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

2. - On February 19, 2015, Telefónica, S.A., as the borrower, and a group of credit entities, as the lenders, where Citibank International Limited acted as the agent bank, signed a syndicated loan contract for a total of 2.5 billion euros. On the same date, Telefónica, S.A. signed an amendment of another syndicated loan of 3.0 billion euros, formalised on February 18, 2014 where The Royal Bank of Scotland, PLC was the agent bank.

On November 17, 2015, Telefónica, S.A. and a group of credit entities, in which Banco Bilbao Vizcaya Argentaria, S.A. was the agent bank, signed a syndicated loan contract for a total of 3.0 billion euros.

According to the terms and conditions of the three financing contracts, in the event of a change of control occurring in Telefónica, S.A., then, under certain circumstances, the lending entities may request the early cancellation of these financing contracts.

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

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

Number of beneficiaries	48
Type of beneficiary	

Executive Directors, Senior Managers and other Employees

Description of the resolution

With regard to the termination of Executive Directors' contracts, since 2006 the Company's policy thereon has, in line with common market practices, included a clause giving them the right to receive compensation equivalent to two years' remuneration based on the last fixed remuneration and the arithmetical mean of the sum of the last two annual variable payments received in the event that their employment relationship is ended for reasons attributable to the Company or is due to objective reasons such as a change of control in the Company. However, if the employment relationship is terminated for a breach attributable to the Executive Director or Executive, he/she will not be entitled to any compensation whatsoever.

The aforementioned compensation criteria are therefore included in contracts entered into since 2006.

In the case of pre-2006 contracts, the severance benefit to be received by an Executive Director according to their contract is not calculated as per these criteria, but rather is based on other circumstances of a personal or professional nature or on the time when the contract was signed. In these instances, the agreed economic compensation for the termination of the employment relationship, where applicable, consists of four years' of remuneration at the most based on length of service at the Company. Annual remuneration on which the indemnity is based is the last fixed remuneration and the arithmetic mean of the last two variable remuneration payments received by contract.

The Executive Director no longer has indemnity or a "golden parachute" clause.

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

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

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

	Board of Directors	General Shareholders Meeting
Body authorizing clauses	Yes	No

Is the General Shareholders' Meeting informed of such clauses?	Yes

C.2. Board committees

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

EXECUTIVE COMMISSION

Name	Position	Professional category
Mr. César Alierta Izuel	Chairman	Executive
Mr. Isidro Fainé Casas	Vice Chairman	Proprietary
Mr. José María Abril Pérez	Vice Chairman	Proprietary
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José María Álvarez-Pallete López	Member	Executive
Mr. Peter Erskine	Member	Independent

% of executive directors	22.22%
% of proprietary directors	22.22%
% of independent directors	55.56%
% of Other External Directors	0.00%

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

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

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

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

a) Composition.

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

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

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

b) Operation.

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

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

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

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

c) Relationship with the Board of Directors.

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

Most significant actions during the year.

During the 2015 year, the Executive Commission of the Board of Directors of Telefónica, S.A. has analysed, reviewed, deliberated upon and adopted resolutions on a range of matters concerning, inter alia:

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

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

Yes

AUDIT AND CONTROL COMMITTEE

Name	Position	Professional category
Mr. Carlos Colomer Casellas	Chairman	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Ignacio Moreno Martínez	Member	Proprietary

% of proprietary directors	40.00%
% of independent directors	60.00%
% of Other External Directors	0.00%

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

See heading H "Other information of interest", Note 15 to Section C.2.1.

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

Name or Director with experience
Mr. Antonio Massanell Lavilla
No. years Chairman has held this position
3

NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Position	Professional category
Mr. Alfonso Ferrari Herrero	Chairman	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Pablo Isla Álvarez de Tejera	Member	Independent
Mr. Peter Erskine	Member	Independent

% of proprietary directors	0.00%
% of independent directors	100.00%
% of Other External Directors	0.00%

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

See heading H "Other information of interest", Note 16 to Section C.2.1.

REGULATION COMMITTEE

Name	Position	Type
Mr. Gonzalo Hinojosa Fernández de Angulo	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. José Fernando de Almansa Moreno-Barreda	Member	Other External
Ms. Eva Castillo Sanz	Member	Other External
Mr. Ignacio Moreno Martínez	Member	Proprietary

% of proprietary directors	16.67%
% of independent directors	50.00%
% of Other External Directors	33.33%

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

Pursuant to the provisions of Article 24 of the Regulation of the Board of Directors of the Company, the Regulation Committee is regulated in the following terms:

a) Composition.

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

The Chairman of the Regulation Committee is appointed from among its members.

b) Duties.

Notwithstanding other duties entrusted to it by the Board of Directors, the Regulation Committee shall have at least the following functions:

1) To monitor on a permanent basis the principal regulatory matters and issues affecting the Telefónica Group at any time, through the study, review and discussion thereof.

2) To act as a communication and information channel for regulatory matters between the management team and the Board of Directors and, where appropriate, to advise the latter of those matters deemed important or significant to the Company or to any of the companies of its Group in respect of which it is necessary or appropriate to make a decision or adopt a particular strategy.

Most significant actions during the year.

The regulatory matters of most significance for the Telefónica Group were analysed and discussed by the Regulation Committee during its four meetings held in 2015, and were set out in the Regulatory Agenda - at global and European Union level, by regions (Europe and Latin America) and by countries. The most significant developments, as set out in the Regulatory Agenda, are updated in each meeting, and also in the specific documents or reports submitted to the Committee, when deemed advisable.

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

SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Position	Professional category
Mr. Antonio Massanell Lavilla	Chairman	Proprietary
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Ms. Eva Castillo Sanz	Member	Other External
Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of proprietary directors	28.57%
% of independent directors	57.14%
% of other external directors	14.29%

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

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

a) Composition.

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

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

b) Duties.

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

1) To periodically examine, review and monitor the quality indices of the principal services provided by the companies of the Telefónica Group.

2) To evaluate levels of customer service provided by the companies of the Group to their customers.

c) Most significant actions during the year.

In the four meetings held by the Quality Committee in 2015, it analysed the quality metrics of the main services provided by Telefónica Group companies, while the levels of commercial attention these companies provide to their customers was assessed.

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

INSTITUTIONAL AFFAIRS COMMITTEE

Name	Position	Professional category
Mr. Julio Linares López	Chairman	Other External
Mr. José Fernando de Almansa Moreno-Barreda	Member	Other External
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of proprietary directors	16.67%
% of independent directors	50.00%
% of other external directors	33.33%

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

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

a) Composition.

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

The Chairman of the Institutional Affairs Committee is appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the Institutional Affairs Committee's main duty shall be to examine and analyse matters and issues relating to the Telefónica Group's institutional relations.

Most significant actions during the year.

The Institutional Affairs Committee held 11 meetings in the 2015 year, in which it performed continuous monitoring of, on the one hand, the Sponsorship and Patronage Policy, and the Sponsorships presented by the Institutional Relations and Sponsorships area of Telefónica, S.A., and, on the other hand, the Corporate Social Responsibility of the Telefónica Group and of the most significant issues in this field.

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

STRATEGY COMMITTEE

Name	Position	Professional category
Mr. Peter Erskine	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José Fernando de Almansa Moreno-Barreda	Member	Other External
Ms. Eva Castillo Sanz	Member	Other External
Mr. Julio Linares López	Member	Other External

% proprietary directors	0.00%
% independent directors	50.00%
% of other external directors	50.00%

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

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

a) Composition.

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

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

b) Duties.

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Strategy Committee shall be to support the Board of Directors in analysing and monitoring the Telefónica Group's global strategy policy.

Most significant actions during the year.

The Strategy Committee held 11 meetings in the 2015 year, in which it analysed a number of different issues, which mainly concerned the telecommunications sector, in keeping with the strategic policy of the Telefónica Group and its business, and questions relating to these matters.

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

INNOVATION COMMITTEE

Name	Position	Professional category
Mr. Carlos Colomer Casellas	Chairman	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. José María Abril Pérez	Member	Proprietary
Mr. Peter Erskine	Member	Independent
Mr. Julio Linares López	Member	Other External

% proprietary directors	40.00%
% independent directors	40.00%
% of other external directors	20.00%

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

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

a) Composition.

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

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

b) Duties.

The Innovation Committee is primarily responsible for advising and assisting in all matters regarding innovation. Its main object is to perform an examination, analysis and periodic monitoring of the Company's innovation projects, to provide guidance and to help ensure its implementation and development across the Group.

Most significant actions during the year.

In the 11 meetings held by the Innovation Committee in the 2015 year, it performed a regular monitoring of the Company's innovation projects, providing guidance and offering its support to help ensure its implementation and development across the Group.

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

Action Plan and Report

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

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

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

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

	Number of female directors			
	2015 Number %	2014 Number %	2013 Number %	2012 Number %
Executive Commission	0	0	0	0
Audit and Control Committee	0	0	0	0
Nominating, Compensation and Corporate Governance Committee	0	0	0	0
Regulation Committee	1 (16.67%)	1 (16.67%)	1 (14.29%)	1 (20.00%)
Service Quality and Customer Service Committee	1 (14.29%)	1 (14.29%)	1 (14.29%)	1 (16.67%)
Institutional Affairs Committee	0	0	0	0
Strategy Committee	1 (16.67%)	1 (16.67%)	1 (16.67%)	1 (20.00%)
Innovation Committee	0	0	0	0

C.2.3 Section eliminated.

C.2.4 Section eliminated.

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

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

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

C.2.6 Section eliminated.

D. Related-party and intragroup transactions

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

Procedure for reporting on approval of related-party transactions.

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

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

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

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

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

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

1. They are performed by virtue of contracts whose conditions are standardised and are applied on an across-the-board basis to a large number of clients,

2. They are performed at prices or tariffs generally set by the person supplying the goods or services, and

3. Their amount is not more than one per cent of the company's annual revenues.

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

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

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

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

Name or corporate name of significant shareholder	Name or corporate name of the company or its group company	Nature of the relationship	Type of transaction	Amount (Thousands of euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	7,410
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	3,627
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest charged	1,017

Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Others	18,498,985
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: loans	420,517
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees	67,959
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: other	54,013
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earning	211,892
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest paid	17,060
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	648
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	946
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase of goods (finished or in progress)	656
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest charged	14,084
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Management contracts	842
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	34,692
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	5,752
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Others	1,522,510
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance arrangements: loans	113,868
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees	249,525
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	617
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Interest paid	604
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Receipt of services	3,375
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Interest charged	963
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Finance arrangements: loans	412,211
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Guarantees	8,243
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Finance arrangements: other	49,470
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	112,630
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Telefónica, S.A.	Contractual	Others	1,240,623
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Receipt of services	10,092
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Purchase of goods (finished or in progress)	53,449
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Services rendered	52,127
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	63,618
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Finance arrangements: loans	10,000
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Operating lease contracts	6,282
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Guarantees	30,341
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Purchase options commitments	79,063
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Other	168,000
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Operating lease contracts	25
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Interest paid	188
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Operating lease contracts	244
Fundación Bancaria Caixa d´Estalvis i Pensions de Barcelona	Rest of Telefónica Group	Contractual	Interest charged	5

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

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

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

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

38,174 thousand euros

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

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

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

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

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

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

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

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

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

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

1. They are performed by virtue of contracts whose conditions are standardised and are applied on an across-the-board basis to a large number of clients,

2. They are performed at prices or tariffs generally set by the person supplying the goods or services, and

3. Their amount is not more than one per cent of the company's annual revenues.

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

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

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

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

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

No

Please specify the subsidiary companies listed in Spain:

Subsidiary companies listed

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

No

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

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

Mechanisms to resolve possible conflicts of interest

E. Risk control and management systems

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

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

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

a) Business risk: Possible loss of value or earnings as a result of strategic uncertainty or uncertainty about competitors, changes in the business, competition and market scenario, or changes in the legal framework.

b) Operational risk: Possible loss of value or earnings as a result of events caused by inadequacies or failures in customer service, processes, human resources, business teams and IT systems, security, compliance with contracts, laws and regulations, or due to external factors.

c) Financial risk: Possible loss of value or earnings as a result of adverse movements in financial variables and the inability of the Company to meet its obligations or convert its assets into cash. Additionally the risks of a fiscal nature are included in this category.

d) Global risk: Possible loss of value or earnings as a result of events that affect in a transversal way the entire Telefónica Group in terms of its corporate reputation and responsibility, corporate public relations, marketing strategy, brand, sponsorship and innovation.

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

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

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

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

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

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

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

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

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

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

- Generally, albeit mainly related to operational and business risks, tolerance thresholds are defined pursuant to the impact and probability of the risk. These thresholds are revised annually based on the performance of the main financials for both the Group as a whole and the business lines and main companies therein.

- The tolerance level for financial risks (including fiscal risks) is set in terms of their economic impact.

- A zero-tolerance level is established for global risks, principally those affecting corporate reputation and responsibility.

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

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairment in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. For example, with respect to the investment in Telco, S.p.A. (Telco), value adjustments were made in 2014 with a negative impact of 464 million euros.

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

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

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

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

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

F. Internal Control over Financial Reporting (ICFR) Systems

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

F.1. The company's control environment

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In December 2006, Telefónica's Board of Directors approved the unification of the Codes of Ethics of the Group's different companies in the new "Code of Ethics of Telefónica, Our Business Principles", to be applied as standard in all countries where the Telefónica Group operates, and for all its employees (at all levels of the organisation, directors and non-directors). The "Code of Ethics of Telefónica, Our Business Principles" has been updated in 2015.

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

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

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

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

The Office is in charge of:

1. Guaranteeing that Telefónica conducts business in an ethical and responsible manner, and that the Company's reputation is not tarnished.
2. Developing the mechanisms need to ensure the Code of Ethics is followed to the letter in all regions/countries/business units.
3. Overseeing, reviewing and contemplating the implementation of the Business Principles across the entire Telefónica Group.

   Training courses are provided to all employees through the online training platform to reinforce knowledge of these Business Principles.
4. Examining any matters or proposals in the Group that could represent a risk to the Business Principles and associated policies and therefore, the brand and reputation.

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

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

Telefónica, S.A. also has an “Internal Code of Conduct" for Securities Markets, setting out the general guidelines and principles of conduct for the persons involved in securities and financial instrument transactions entered into by the Company and its subsidiaries.

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

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

The Telefónica Group has two whistle-blowing channels:

SOX Whistle-blowing Channel: this channel was approved by the Audit and Control Committee in April 2004 to fulfil the obligations laid down in the Sarbanes-Oxley Act (SOX), as a listed company on the New York Stock Exchange. It is open to all Telefónica Group employees. Any irregularities reported through the channel must only be related with financial-accounting information, internal controls thereof, and/or audit-related matters.
This channel is confidential and anonymous, since the contents of any reports are sent automatically to the Secretary of Telefónica S.A.'s Audit and Control Committee after removing the sender's name, and the source of the message cannot be traced in any event.
The channel is accessible through the Internal Audit webpage on Telefónica's intranet.
The Audit and Control Committee receives all complaints made through this channel regarding internal controls, accounting or the audit of the financial statements. All complaints of this nature will be treated and resolved by the Committee appropriately.

Business Principles Whistle-blowing Channel: in addition to the "Business Principles" ethical code, the Board of Directors approved a whistle-blowing channel for employees. In it, professionals can notify the Company of any behaviour, actions or events that could breach the ethical code, the Company's internal rules, or any regulations governing its activity, and jeopardise the contractual relationship between the Company and the accused party. Questions, advice and information on compliance with the Business Principles and associated policies and rules can also be submitted through this channel.

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

Telefónica S.A.'s Office of Business Principles is responsible for the Business Principles Whistle-blowing Channel.

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

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

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

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

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

F.2. Risk assessment in financial reporting

Report, at least:

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

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

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

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

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

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

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

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

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

1. Business risks

2. Operational risks
3. Global risks
4. Financial risks

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

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

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

F.3. Control activities

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

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

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

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

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

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

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

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

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

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

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

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

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

The Corporate Information Security Policy defines information and the systems which process it as strategic assets, and sets out the security requirements which must be met by Group companies, and the guidelines which they are obliged to follow, through implementing the adequate controls, in accordance with the following domains:

- Organisation and functions
- Personnel obligations
- Information classification and processing
- Identification and authentication
- Control of access
- Auditing and monitoring records
- Networks and communications
- Control of software
- Systems development and maintenance
- Incident management
- Media management and distribution
- Back-up and recovery
- Business continuity
- Physical and environmental security
- Compliance with prevailing legislation

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

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

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

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

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

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

F.4. Information and communication

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

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

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

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

Also, the Telefónica Group has an Accounting Policies Manual which is updated annually. The last update took place in December 2015. The objectives of this manual are: to align the corporate accounting principles and policies with IFRS; to maintain accounting principles and policies which ensure that the information is comparable within the Group and offers optimum management of the source of information; to improve the quality of the accounting information of the various Group companies and of the Consolidated Group by disclosing, agreeing and introducing accounting principles which are unique to the Group; and to facilitate the accounting integration of acquired and newly-created companies into the Group's accounting system by means of a reference manual.

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

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

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

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

There is a Compliance Manual for Consolidation Reporting which includes specific instructions on preparing the disclosures which comprise the reporting for the consolidation of the Telefónica Group's financial statements and the preparation of consolidated financial information.

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

F.5. System function monitoring

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

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

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

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

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

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

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

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

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

To fulfil this objective, the Telefónica Group uses a three-tier internal control of financial reporting evaluation model, while every year the Internal Audit function is responsible for evaluating its performance.

Self-appraisal Questionnaires

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

Review of processes and specific controls

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

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

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

Review of general controls

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

Supervision of general controls on data systems is designed to review management of changes to programmes, data and systems access and management of changes to infrastructure, back up, scheduled tasks and issues.

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

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

As explained beforehand, the Internal Audit unit also provides support to the Audit and Control Committee in monitoring the correct functioning of the ICFR system. The Internal Audit unit participates in the Audit and Control Committee meetings, and reports regularly on the findings of the performed tasks, as well as action plans established to mitigate and the degree of implementation thereof.

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

F.6. Other relevant information

Not applicable

F.7 .External auditor review

State whether:

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

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

G DEGREE OF COMPLIANCE WITH CORPORATE GOVERNANCE RECOMMENDATIONS

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

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

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

Explain

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

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

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

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

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

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

In addition, the special requirements for appointment as Director (Article 30 of the Corporate Bylaws) or as Chairman, Vice-Chairman, Chief Executive Officer or member of the Executive Commission (Article 31 of the Corporate Bylaws) are justified by the desire that access to the management decision-making body and to the most significant positions thereon is reserved to persons who have demonstrated their commitment to the Company and who, in addition, have adequate experience as members of the Board, such that continuity of the management model adopted by the Telefónica Group may be assured in the interest of all of its shareholders and stakeholders. In any event, these special requirements may be waived by broad consensus among the members of the Board of Directors, namely, with the favorable vote of at least 85 percent of its members, as provided by the aforementioned Articles of the Corporate Bylaws.

2. When a dominant and a subsidiary company are both listed, they should provide detailed disclosure on:

a) The activity they engage in and any business dealings between them, as well as between the listed subsidiary and other group companies.

b) The mechanisms in place to resolve possible conflicts of interest.

Not applicable

3. During the annual general meeting the Chairman of the Board should verbally inform shareholders in sufficient detail of the most relevant aspects of the company's corporate governance, supplementing the written information circulated in the Annual Corporate Governance Report. In particular:

a) Changes taking place since the previous annual general meeting.

b) The specific reasons for the company not following a given Good Governance Code recommendation and any alternative procedures followed in its stead.

Complies

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

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

Complies

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

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

Complies

6. **Listed companies drawing up the following reports on a voluntary or compulsory basis should publish them on their website well in advance of the annual general meeting, even if their distribution is not obligatory:**
   a) **Report on auditor independence.**
   b) **Reviews of the operation of the Audit Committee and the Nomination and Remuneration Committee.**
   c) **Audit Committee report on third-party transactions.**
   d) **Report on corporate social responsibility policy.**

Complies

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

Explain

The Company decided not to offer a live webcast of its 2015 General Shareholders Meeting, for organisational reasons and owing to the way the Meeting was developed (possible changes which could arise). Nonetheless, Telefónica is analysing the possibility of broadcasting future General Shareholders meetings live on its website.

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

Complies

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

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

Complies

10. **When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the general meeting, the company should:**
    a) **Immediately circulate the supplementary items and new proposals.**

b) **Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the Board of Directors.**

c) **Put all these items or alternative proposals to the vote applying the same voting rules as for those submitted by the Board of Directors, with particular regard to presumptions or deductions about the direction of votes.**

d) **After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.**

Not applicable

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

Not applicable

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

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

Complies

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

Explain

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

In addition, it is important to bear in mind the Company's large number of Board committees, which ensures the active participation of all its Directors.

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

a) **Is concrete and verifiable.**

b) **Ensures that the appointment or reelection proposals are based on a prior analysis of the Board's needs.**

c) **Favours a diversity of knowledge, experience and gender.**

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

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

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

Complies

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

Complies

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

This criterion can be relaxed:

a) **In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.**

b) **In companies with a plurality of shareholders represented on the Board but not otherwise related.**

Explain

The aforementioned recommendation 16 refers to the composition of the group of External Directors. As stated in Section C.1.3 of this Annual Corporate Governance Report, at 31 December 2015, the group of External Directors of Telefónica, S.A. was composed of 15 members (of a total of 18 Members), of whom 5 are Proprietary Directors, 7 are Independent Directors and 3 falls under the "Other External Directors" category.

Of the five Proprietary Directors, two act in representation of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa", which holds 5.01% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 6.07% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.29% stake.

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

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

In this regard, Telefónica ranks among the top listed companies on Spanish stock exchanges in terms of stock market capitalization, reaching the figure of 50,921 million euros at December 31, 2015, which means a very high absolute value of the stakes of "la Caixa" and BBVA in Telefónica (that of "la Caixa" is 2,551 million euros, and that of BBVA is 3,091 million euros). This justifies the overrepresentation of these entities on the Board of Directors, rising from one member of the Board each (to which they would strictly have the right in accordance with Article 243 of the Spanish Corporations Act) to two members, i.e. permitting the appointment of just one more Proprietary Director over the strictly legal proportion.

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

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

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

Explain

Telefónica, S.A. operates in a particularly complicated sector and one which is constantly changing, in which it is necessary to have a Board of Directors who are highly qualified, who are experts in the many different businesses and geographical areas in which the Company conducts its business.

Consequently, the Company has judged that the Board of Directors must necessarily include former executives of Telefónica, S.A. who have a far-reaching knowledge of the sector and the Company's businesses, and who because of their previous relations with the Company cannot be considered to be independent.

Because of this policy, the percentage of members of the Board of Directors which may be considered as independent is slightly lower than 50% (7 instead of 9, the latter figure representing exactly half of the Board, which is made up of 18 directors).

In any event, Telefónica, S.A. believes that the structure of its Board of Directors – which is largely made up of non-executive Directors – includes directors who have the ideal profile to reinforce its leadership in the communications sector, while also effectively safeguarding its members' independence, taken as a whole.

18. Companies should disclose the following Director particulars on their websites and keep them regularly updated:

a) Background and professional experience.

b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.

c) Statement of the Director class to which they belong, in the case of proprietary Directors indicating the shareholder they represent or have links with.

d) Dates of their first appointment as a board member and subsequent re-elections.

e) Shares held in the company, and any options on the same.

Complies

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

Complies

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

Complies

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

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

Complies

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

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

Complies

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

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

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

Complies

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

Complies

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

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

Complies

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

Complies

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

Complies

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

Complies

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

Complies

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

Complies

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

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

Complies

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

Complies

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

Complies

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

Complies

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

Complies

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

    a) **The quality and efficiency of the Board's operation.**

    b) **The performance and membership of its Committees.**

    c) **The diversity of board membership and competences.**

    d) **The performance of the Chairman of the Board of Directors and the company's chief executive.**

    e) **The performance and contribution of individual Directors, with particular attention to the chairmen of board committees.**

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

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

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

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

Complies

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

Complies

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

Complies

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

Complies

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

Complies

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

Complies

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

1º With respect to internal control and reporting systems:

a) Monitor the preparation and the integrity of the financial information prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.

b) Monitor the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.

c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2º With regard to the external auditor:

a) Investigate the issues giving rise to the resignation of the external auditor, should this come about.

b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.

c) Ensure that the company notifies any change of external auditor to the CNMV as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.

d) **Ensure that the external auditor has a yearly meeting with the Board in full to inform it of the work undertaken and developments in the company's risk and accounting positions.**

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

Complies

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

Complies

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

Complies

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

a) **The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance sheet risks.**

b) **The determination of the risk level the company sees as acceptable.**

c) **The measures in place to mitigate the impact of identified risk events should they occur.**

d) **The internal control and reporting systems to be used to control and manage the above risks, including contingent liabilities and off-balance sheet risks.**

Complies

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

a) **Ensure that risk control and management systems are functioning correctly and, specifically, that major risks the company is exposed to are correctly identified, managed and quantified.**

b) **Participate actively in the preparation of risk strategies and in key decisions about their management.**

c) **Ensure that risk control and management systems are mitigating risks effectively in the frame of the policy drawn up by the Board of Directors.**

Complies

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

Complies

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

Explain

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

Notwithstanding the above, The Board of Directors of Telefónica, S.A. currently has seven Consultative Committees, in addition to its Executive Commission: which are the Audit and Control Committee, the Nominating, Compensation and Corporate Governance Committee, Regulation Committee, Service Quality and Customer Care Committee, Institutional Affairs Committee, Innovation Committee and the Strategy Committee).

To date, the Board of Directors has not considered separating the functions of the Nominating, Compensation and Corporate Governance Committee because it believes that by putting the powers to assess Directors and determine their remuneration in the same Committee, is helpful to coordinate and to produce a results-driven remuneration system (pay for performance).

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

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

Complies

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

a) **Propose to the Board the standard conditions for senior officer contracts.**

b) **Monitor compliance with the remuneration policy set by the company.**

c) Periodically review the remuneration policy for Directors and senior officers, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other Directors and senior officers in the company.

d) Ensure that conflicts of interest do not undermine the independence of any external advice the Committee engages.

e) Verify the information on Director and senior officers' pay contained in corporate documents, including the annual Directors' remuneration statement.

Complies

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

Complies

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

a) Committees should be formed exclusively by Non-executive Directors, with a majority of independents.

b) They should be chaired by independent Directors.

c) The Board should appoint the members of such committees with regard to the knowledge, skills and experience of its Directors and each committee's terms of reference; discuss their proposals and reports; and provide report-backs on their activities and work at the first board plenary following each committee meeting.

d) They may engage external advice, when they feel it necessary for the discharge of their functions.

e) Meeting proceedings should be minuted and a copy made available to all board members.

Explain

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

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

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

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

53. The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one board committee or split between several, which could be the Audit Committee, the Nomination Committee, the Corporate social responsibility Committee, where one exists, or a dedicated committee established ad hoc by the Board under its powers of self-organisation, with at the least the following functions:

a) Monitor compliance with the company’s internal codes of conduct and corporate governance rules.

b) Oversee the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.

c) Periodically evaluate the effectiveness of the company’s corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.

d) Review the company’s corporate social responsibility policy, ensuring that it is geared to value creation.

e) Monitor corporate social responsibility strategy and practices and assess compliance in their respect.

f) Monitor and evaluate the company’s interaction with its stakeholder groups.

g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.

h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

Complies

54. The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:

a) The goals of its corporate social responsibility policy and the support instruments to be deployed.

b) The corporate strategy with regard to sustainability, the environment and social issues.

c) Concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.

d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.

e) The mechanisms for supervising non-financial risk, ethics and business conduct.

f) Channels for stakeholder communication, participation and dialogue.

g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

Complies

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

Complies

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

Complies

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

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

Complies

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

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

    a) **Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.**

    b) **Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.**

c) **Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards ongoing achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.**

Complies

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

Complies

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

Complies

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

Complies

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

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

Explain

Executive Directors have the following shareholdings in Telefónica, S.A.:

- Mr. César Alierta Izuel has 5,293,554 voting rights which, valued at a price of 10.235 euros, account for 2,429% of his fixed remuneration.

- Mr. Jose María Álvarez-Pallete López has 553,208 voting rights which, valued at a price of 10.235 euros, account for 294 % of his fixed remuneration.

- Mr. Santiago Fernández Valbuena has 217,554 voting rights which, valued at a price of 10.235 euros, account for 221 % of his fixed remuneration.

These shareholdings owned by Executive Directors demonstrate their commitment to Telefónica, and show that their own interests are aligned with the other shareholders' interests.

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

Partially complies

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

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

Partially complies

With regard to the termination of Executive Directors' contracts, since 2006 the Company's policy thereon has, in line with common market practices, included a clause giving them the right to receive compensation equivalent to two years' remuneration based on the last fixed remuneration and the arithmetical mean of the sum of the last two annual variable payments received in the event that their employment relationship is ended for reasons attributable to the Company or is due to objective reasons such as a change of control in the Company. However, if the employment relationship is terminated for a breach attributable to the Executive Director or Executive, he/she will not be entitled to any compensation whatsoever.

The aforementioned compensation criteria are therefore included in contracts entered into since 2006.

In the case of pre-2006 contracts, the severance benefit to be received by an Executive Director according to their contract is not calculated as per these criteria, but rather is based on other circumstances of a personal or professional nature or on the time when the contract was signed. In these instances, the agreed economic compensation for the termination of the employment relationship, where applicable, consists of four years' of remuneration at the most based on length of service at the Company. Annual remuneration on which the indemnity is based is the last fixed remuneration and the arithmetic mean of the last two variable remuneration payments received by contract.

The Executive Director no longer has indemnity or a "golden parachute" clause.

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

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

H Other information of interest

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

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

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

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

GENERAL CLARIFICATION: It is hereby stated that the details contained in this report refer to the financial year ended on December 31, 2015, except in those issues in which a different date of reference is specifically mentioned.

- Note 1 to Section A.2.]

On February 9, Blackrock, Inc. filed a Schedule 13G at the Securities Exchange Commission stating that it indirectly owned a total of 253,632,799 shares of Telefónica, S.A. (accounting for 5.09% of the share capital of Telefónica, S.A., at the date of this report). However, as expressly indicated in the aforementioned Schedule 13G, Blackrock, Inc. only has voting rights for 233,260,845 shares of Telefónica, S.A. (which account for 4.68% of the share capital of Telefónica, S.A. at the date of this report).

- Note 2 to Section A.3.]

It should be noted that the Company has an Internal Code of Conduct for Securities Markets Issues setting out, among other issues, the general operating principles for Directors and senior executives when carrying out personal trades involving securities issued by Telefónica, S.A. and financial instruments and contracts whose underlying securities or instruments are issued by the Company.

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

- Note 3 to Section A.3.]

On January 26, 2016 and February 18, 2016, Mr. César Alierta Izuel notified the Spanish Securities Market Commission of the acquisition of 15 share and 17 shares, respectively, of Telefónica, S.A., as part of the Global Employee Share Plan ("GESP") approved by the Ordinary General Shareholders Meeting of the Company held on May 30, 2014.

On January 26, 2016 and February 18, 2016, Mr. José María Álvarez-Pallete López notified the Spanish Securities Market Commission of the acquisition of 15 share and 17 shares, respectively, of Telefónica, S.A., as part of the Global Employee Share Plan ("GESP") approved by the Ordinary General Shareholders Meeting of the Company held on May 30, 2014.

On January 26, 2016 and February 18, 2016, Mr. Santiago Fernández Valbuena notified the Spanish Securities Market Commission of the acquisition of 11 share and 13 shares, respectively, of Telefónica, S.A., as part of the Global Employee Share Plan ("GESP") approved by the Ordinary General Shareholders Meeting of the Company held on May 30, 2014.

- Note 4 to Section A.3.]

At the General Shareholders Meeting on May 18, 2011, shareholders approved the introduction of a long-term incentive plan for managers of the Group (including Executive Directors) known as the Performance & Investment Plan ("PIP"). Under this plan, participants who met the qualifying requirements were awarded a certain number of Telefónica, S.A. shares as a form of variable remuneration. This General Shareholders Meeting approved the maximum number of shares to be awarded to Executive Directors subject to their meeting the Co-Investment requirement established in the Plan and the maximum target total shareholder return (TSR) established for each phase.

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

In accordance with the above, the amounts appearing in Section A.3. of this report under "Number of direct votes" and "Equivalent number of shares" (i.e. Mr. César Alierta Izuel, 972,000-1,518,750; Mr. José María Álvarez-Pallete López, 576,000-900,000; and Mr. Santiago Fernández Valbuena, 208,000-325,000) relate to the theoretical number of shares assigned and the maximum possible number of shares in the third phase of the Plan approved by the General Shareholders Meeting of 30 May 2014, if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met.

In the case of Mr. Santiago Fernández Valbuena, the above figure includes 500,000 call options, granting him the right to acquire 500,000 shares of Telefónica, S.A. on the expiry date (September 2, 2016), with a strike price of 15.31 euros.

- Note 5 to Section A.6.]

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

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

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

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

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

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

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

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

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

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

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

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

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

Telefónica maintains its commitment to the Strategic Partnership with China Unicom.

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

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

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

- Note 6 to Section A.9.bis]

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

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

Now that these lock up periods have elapsed, Telefónica cannot say if Vivendi, S.A. has proceeded to sell, either partially or in full, the 46.0 million shares which account for 0.95% of the share capital of Telefónica, S.A. However, the aforesaid percentage of 0.95% of share capital has not been included in the percentage of "estimated free-float capital" set out in section A.9.bis of this Report.

- Note 7 to Section A.10.]

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

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

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

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

- Note 8 to Section C.1.12.]

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

- Note 9 to Section C.1.16.]

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

- Note 10 to Section C.1.17.]

Mr.Antonio Massanell Lavilla is the Non-Executive Chairman of Cecabank, S.A.

Mr. Antonio Massanell Lavilla is member of the Supervisory board of Erst Group Bank.

Mr. José Fernando de Almansa Moreno-Barreda is Acting Director of Grupo Financiero BBVA Bancomer, S.A. de C.V. and of BBVA Bancomer, S.A.

- Note 11 to Section C.1.18]

Following the approval of the resolutions to amend the Bylaws and the Regulations of the Board of Directors adopted in the General Shareholders Meeting held on June 12, 2015, the Board of Directors held a meeting on November 25, 2015 in which it approved the amendment of its Regulations, within a framework of proper coordination between the regulatory texts dealing with the corporate governance regulations of the Company.

As with the amendments of the Bylaws, the modification of the Board of Directors Regulations is mainly aimed at incorporating the amendments approved by the General Shareholders Meeting in the regulatory text, thereby adapting it to the legal reforms introduced in the Spanish Corporations Act by Act 31/2014, of 3 December, which amends the Spanish Corporations Act in order to improve corporate governance.

The amendment of the Board of Directors' Regulation, i) has taken into account the contents of the new recommendations included in the Corporate Governance Code of Listed Companies, approved by a resolution of the Board of the National Securities Exchange Commission (CNMV) on February 18, 2015, given the Company's multi-national profile and its specific characteristics; and ii) has taken advantage of the reform to adapt the Regulations of the Board of Directors to the new developments in the Audit and Control Committee regulation introduced by the Account Auditing Act 22/2015, of 20 July.

In particular, the proposal focuses on the following areas:

1. Amendment of Articles 5 and 7, concerning General Functions and the Business Principles of the Board of Directors, to: i) reflect the new legal dispositions of Articles 249 bis and 529 ter of the Spanish Corporations Act, and ii) adapt its content to Articles 204.1, 217.4 and 228.d) of the Spanish Corporations Act and comply with Recommendation 12 of the Corporate Governance Code of Listed Companies.

2. Amendment of Article 9, regarding the Qualitative Composition of the Board of Directors, to adapt it to the wording of Article 529 duodecies of the Spanish Corporations Act.

3. Amendment of Articles 10, 11 and 12, on the Nominating and Termination of Directors (Article 10 “Selection, nominating, re-election and ratification of Directors”; Article 11 “Tenure”; and Article 12 “Termination of Directors”), to: i) adapt them to the requirements introduced in Articles 529 decies.7 and 529 bis of the Spanish Corporations Act and also, partially, the contents of Recommendation 14 of the Corporate Governance Code of Listed Companies, ii) its/their adaptation to the amendment of Article 29.1 of the Bylaws, which is in turn necessitated by Article 529 undecies of the Spanish Corporations Act, and iii) formalise compliance of Recommendations 21 and 24 of the Corporate Governance Code of Listed Companies.

4. Amendment of Articles 13 and 14, concerning the Chairman and Vice Chairman of the Board of Directors, to adapt the new dispositions of Article 529 sexies of the Spanish Corporations Act, and taking into account Recommendation 33 of the Corporate Governance Code for Listed Companies.

5. Amendment of Article 17, regarding the Lead Independent Director, to adapt it to the new Article 529 septies of the Spanish Corporations Act, and comply with Recommendation 34 of the Corporate Governance Code for Listed Companies.

6. Amendment of Articles 18 and 19, concerning the Meetings and Development of meetings of the Board of Directors, to adapt the new dispositions of Article 529 quáter, 529 sexies and 529 octies of the Spanish Corporations Act, and taking into account the contents of Recommendation 31 of the Corporate Governance Code for Listed Companies.

7. Amendment of Article 22, which concerns the Audit and Control Committee, to adapt it to Article 529 quaterdecies of the Spanish Corporations Act following the reforms set out in the Account Auditing Act 22/2015, of 20 July, and complying with Recommendations 39 and 44 of the Corporate Governance Code for Listed Companies.

8. Amendment of Article 23, on the Nominating, Remuneration and Corporate Governance Committee, to adapt it to Article 529 quindecies of the Spanish Corporations Act, and to comply with Recommendations 49, 50 and 51 of the Corporate Governance Code of Listed Companies.

9. Amendment of Articles included in Chapter II of Title V of the Board of Directors' Regulations, concerning Directors' Obligations (Article 28 “Duty of diligence”; Article 29 “Duty of loyalty”; Article 30 “Specific manifestations of the duty of loyalty”; and Article 33 “Directors' Responsibility”); to adapt their content to Articles 225, 227, 228, 229, and 230 of the Spanish Corporations Act, taking into account the contents of Recommendation 25 of the Corporate Governance Code for Listed Companies.

10. Amendment of Articles 34 and 35, on the Remuneration of the Board of Directors, to adapt them to the amendment of Article 35 of the Bylaws, and the wording of Articles 529 septdecies and 529 octodecies and –partially – 217.4, all in the Spanish Corporations Act. Technical improvements and improvements in wording are also introduced.

11. Amendment of Articles included in Title VI, concerning the Relations of the Board of Directors (Article 36 “Shareholder relations”; Article 37 “Relations with institutional investors”, which is changed to “Publicity of shareholder relations”; Article 38 “Related party transactions”; Article 39 “Market Relations”; and Article 40 “Relations with Auditor”), in order to adapt them to the dispositions of Articles 230 and 529 ter of the Spanish Corporations Act and to include and to take into account the contents of Recommendations 4, 8, 18, 32 and 42 of the Corporate Governance Code for Listed Companies.

12. A new revised text to include the amendments made in previous sections.

- Note 12 to Section C.1.19.]

Selection and appointment

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

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

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

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

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

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

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

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

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

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

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

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

Re-election

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

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

Appraisal

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

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

Removal and dismissal

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

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

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board alter a report from the Nominating, Compensation and Corporate Governance Committee.

Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

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

- Note 13 to Section C.1.31.]

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

- Note 14 to Section C.1.39.]

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

- Note 15 to Section C.2.1]

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

a) Composition.

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

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

b) Duties.

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

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

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

3) To supervise internal audit and, in particular:

a) Ensure the independence and efficiency of the internal audit function;

b) Propose the selection, appointment and removal of the person responsible for the internal audit;

c) Propose the budget for such service;

d) Review the annual internal audit work plan and the annual activities report;

e) Receive periodic information on its activities; and

f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.

4) Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the

Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.

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

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

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

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

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

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

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

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

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

1. The financial information that the Company must periodically disclose;

2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and

3. Related party transactions.

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

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

c) Operation.

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

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

Most significant actions during the year.

The main activities and actions carried out by the Audit and Control Committee of the Board of Directors of Telefónica, S.A. during 2015 concerned the powers and duties of the Committee, due to both legal requirements and also to the interest arising according to the nature of such powers. The Audit and Control Committee has analysed and reviewed a number of questions which include the following:

- In financial matters: i) review of the Company's financial reporting (2014 Annual Accounts and Management Reports, and the regular quarterly and half-yearly financial information), ii) review of prospectuses presented by the Company to different supervisory Bodies (which include the 20-F Financial Report and a number of Prospectuses for financing (shares and debt) arrangements), and iii) review of single-theme presentations on financial matters and changes in accounting standards.
- Regarding the external auditor: i) proposed appointment and fees to be received, ii) review of audit tasks and limited reviews conducted by the external auditor with regard to the financial reporting referred to above.
- Regarding internal control: i) of cross-cutting processes, investigations and inspections, ii) risk management system, and iii) inspection, investigation and fraud tasks in the field of regulatory compliance, including anti-corruption rules.

- Note 16 to Section C.2.1.]

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

a) Composition.

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

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

b) Duties.

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

1) Assess the skills, knowledge and experience necessary in the Board of Directors. For these purposes, it will define the roles and capabilities required of the candidates to fill each vacancy, and assess the time and dedication necessary for them to efficiently perform their duties.

2) Set a target of representation for the least represented gender on the Board of Directors and provide guidelines about how this target might be reached.

3) Escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.

4) Submit proposed appointments of other Company Directors

to the Board of Directors for appointment by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposals for appointments or termination of the Secretary, and, if applicable, of the Deputy

Secretary of the Board of Directors, and also proposals for the appointment, re-election and termination of Directors in their subsidiary companies.

5) Report on proposals to appoint or to terminate the Senior Management of the Company and their subsidiaries.

6) To report on the proposals for appointment of the members of the Executive Commission and of the other Committees of the Board of Directors, as well as the respective Secretary and, if applicable, the respective Deputy Secretary.

7) To propose to the Board of Directors the appointment of the Lead Director from among the Independent Directors.

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

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

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

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

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

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

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

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

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

c) Operation.

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

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

Most significant actions during the year.

The main activities and actions carried out by the Nominating, Compensation and Corporate Governance Committee of the Board of Directors of Telefónica, S.A. during 2015 concerned the powers and duties of the Committee, due to both legal requirements and also to the interest of the matter arising in each case in accordance with such powers. The Nominating, Compensation and Corporate Governance Committee has analysed and informed a number of questions which include the following:

- The policy and remuneration system for Directors and Executives of the Telefónica Group (fixed and variable remuneration, and action plans).
- Proposed appointments relating to the Board of Directors of Telefónica, S.A. and Subsidiaries.
- Proposed modifications in the organisational structure of the Telefónica Group.
- Modifications in the corporate governance system of Telefónica, S.A., (Bylaws, Regulation of the General Shareholders Meeting and Board of Directors, Director Selection Policy and Reporting, Communication and Contacts with Shareholders, Institutional Investors and Voting Advisors of Telefónica, S.A.).

- 2014 Corporate Governance Report and Remuneration Report.

- Note 17 to Section D. 2.]

It is important to note that:

Transactions included in this section under ´Other´, amounting to 18,498,985 with BBVA, S.A. refer to Dividends received (16,002) and to Derivatives (18,482,983).

Transactions included in this section under ´Other´, for the sum of 1,522,510 with BBVA, S.A. refer to Other Revenues (17,119), to Outstanding factoring operations (163,599), to Other transactions (83), to Other Expenses (265) and to to Derivatives (1,341,444).

Transactions included in this section under ´Other´, for the sum of 1,240,623 with "la Caixa" Group, refer to Derivatives.

Transactions included in this section under ´Other´, for the sum of 168,000 with "la Caixa" Group, refer to Other Expenses (18) and Outstanding factoring operations (150,000)

In addition, the nominal value of outstanding derivatives held with BBVA and la Caixa in 2015 amounted to 19,824 and 1,241 million euros, respectively. As explained in Derivatives policy in Note 16 of the Consolidated Annual Accounts, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying. The fair value of these same derivatives in the statement of financial position is 948 and -26 million euros, respectively, in 2015.

- Note 18 to Section D.5.]

The Director Mr. Carlos Colomer Casellas is an Independent Director of Abertis Infraestructuras, S.A., the parent company of the Abertis Group. Telefónica has entered into agreement with Abertis, through its company On Tower Telecom Infraestructuras, S.A. (formerly called Abertis Tower, S.A.), by virtue of which Telefónica España has sold telephony towers for 44 and 224 million of euros in 2015 and 2014, respectively, reporting profits of 38 million euros in 2015 and of 193 million euros in 2014. it has also been arranged for On Tower Telecom Infraestructuras, S.A. to lease certain spaces in those infrastructure facilities in order for Telefónica Móviles España, S.A.U. to place its communication equipment.

On December 18, 2015, a Joint Venture was set up between China Unicom for the development of Big Data services in China, using "Smart Steps" technology, developed by Telefónica. Telefónica has a stake of 45% through Telefónica Digital España, S.L. and China Unicaom Broadband online Limited Corp. has a stake of 55%. The share capital of this company amounts to 16 million of euros which was not been disbursed at December 31, 2015.

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

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

This annual corporate governance report was approved by the company's Board of Directors at its meeting held on February 24, 2016.
List whether any directors voted against or abstained from voting on the approval of this report.

No

Name or corporate name of director	Reasons (voted against, abstention, non-attendance)	Explain the reasons
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APPENDIX TO THE TELEFÓNICA, S.A. 2015 ANNUAL CORPORATE GOVERNANCE REPORT

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

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

Group-related risks

Worsening of the economic and policy environment could negatively affect business.

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

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

Growth in Europe may be affected by political uncertainty in some European countries (including Spain), a possible revival of the crisis in Greece, restructuring of the banking sector, the impact of steps taken towards a EU banking union and a capital markets union and the referendum to be held in the near future in the United Kingdom, among others. In 2015, the Telefónica Group obtained 26.3% of its revenues in Spain and 16.7% in Germany.

In Latin America, higher exchange rate risks stand out after the large depreciation undergone by most currencies in this region, affected by the fall in commodity prices, the uncertainties about growth in China, and the interest rate evolution in the United States, among other macroeconomic factors. Abrupt exchange rate movements could especially be triggered by scenarios characterized by high inflation and fiscal and external deficits. In this regard, it should be noted that the Venezuelan bolivar exchange rate quoted in SIMADI has remained stable for a year despite the high increase in prices accumulated over this period, increasing the risk of readjustment. In addition, the Argentine peso (which already experienced a sharp depreciation in December 2015) is experiencing some depth constraints in its trading market, and the Brazilian real (which also experienced a depreciation in 2015) has remained volatile at the beginning of 2016. Cash flows from countries in this region could decrease, and financial conditions could become more unfavorable if any of these elements were to worsen in the future.

Some of the most significant macroeconomic risk factors in the region affect Brazil, where there is a combination of high inflation, negative economic growth rates and significant internal and external financing needs. All these elements have led to new downgrades to the country's credit rating.

Moreover, the recent fall in oil prices and other commodity prices is having a negative impact on the external and fiscal accounts in Chile, Peru, Colombia, Mexico, and Ecuador (which has a dollarized economy, and is currently experiencing a lower supply of U.S. dollars).

In Argentina, the new government is focused on resolving Argentina's macroeconomic and financial imbalances and on recovering international confidence. Although reforms taking place may have positive effects in the medium term, short term risks persist.

In Venezuela after the parliamentary elections in which the Democratic Unity Roundtable (an opposition coalition to the ruling United Social Party of Venezuela) claimed the majority of seats in the National Assembly, a new economic emergency decree was announced which could increase state control on private businesses. In addition, there continues to be very limited access to U.S. dollars.

For the year ended December 31, 2015, Telefónica Hispanoamérica and Telefónica Brazil represented 30.5% and 23.4% of the Telefónica Group's revenues, respectively. Moreover, approximately 35.6% of the Group's revenues in the telephony business were generated in countries that do not have investment grade status (in order of importance Brazil, Argentina, Ecuador, Venezuela, Nicaragua, Guatemala, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. At December 31, 2015 the percentage of Telefónica's net financial debt in Latin American currencies stood at 13%.

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

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

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

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

At December 31, 2015, 49.1% of the Group's net debt was pegged to fixed interest rates for a period greater than one year, while 28% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2015: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 245 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, the U.S. dollar and the pound sterling (these to zero rates in order to avoid negative rates), would lead to a reduction in financial expenses of 75 million euros. These calculations were made assuming a constant currency and a balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

According to the Group's calculations, the impact on net financial expense by changes in the value of a 10% depreciation of Latin American currencies against the U.S. dollar and a 10% depreciation of the rest of the currencies against the euro would result in exchange losses of 33 million euros, primarily due to the weakening of the Venezuelan bolívar fuerte and the Argentine peso. These calculations were made assuming a constant currency position with an impact on profit or loss at December 31, 2015, including derivative instruments in place. At December 31, 2015, 31.3% of the Telefónica Group's operating income before depreciation and amortization (OIBDA) was concentrated in Telefónica Brazil and 38.2% in Telefónica Hispanoamérica.

The Telefónica Group uses a variety of strategies to manage these risks, mainly through the use of financial derivatives, which themselves also expose us to risk, including counterparty risk. Furthermore, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

Existing or worsening conditions in the financial markets may limit the Group's ability to finance, and consequently, the ability to carry out its business plan.

The performance, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the development and implementation of Telefónica's strategic plan and new technologies, the renewal of licenses or the expansion of the Telefónica Group's business in countries where it operates, may require a substantial amount of financing.

A decrease in the liquidity of the Company, a difficulty in refinancing maturing debt or raising new funds as debt or equity, could force Telefónica to use resources allocated to investments or other commitments to pay its financial debt, which could have a negative effect on the Group's business, financial condition, results of operations or cash flows.

Funding could be more difficult and costly in the event of a significant deterioration of conditions in the international or local financial markets (especially considering the recent volatility resulting from uncertainties regarding China, the decline in commodity prices and the hikes in interest rates approved by the Federal Reserve, all of which impact Latin America), or if there is an eventual deterioration in the solvency or operating performance of the Company, or if Telefónica's divestment of its operations in the United Kingdom were to not be completed, or as a consequence of a credit rating downgrade of Spanish sovereign risk by rating agencies.

At December 31, 2015, gross financial debt scheduled to mature in 2016 amounted to 11,275 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2017 amounted to 8,461 million euros.

In accordance with its liquidity policy, the Company has fully covered its gross debt maturities until the end of 2016 with cash and credit lines available at December 31, 2015, including a syndicated credit facility signed in November 2015 with several national and foreign institutions amounting to 3,000 million euros with a maturity of up to 27 months. Our liquidity could be affected if Telefónica's divestment of its operations in the United Kingdom is finally not consummated, or if market conditions make it difficult to renew existing undrawn credit lines, 8.7% of which, at December 31, 2015, were scheduled to mature prior to December 31, 2016.

In addition, given the interrelation between economic growth and financial stability, the materialization of any of the economic, political and exchange rate risks referred to above could lead to a negative impact on the availability and cost of Telefonica's financing and its liquidity strategy; which could have, as well, a negative effect on the Group's business, financial condition, results of operations or cash flows.

Telefónica's divestment of its operations in the United Kingdom may not materialize.

On March 24, 2015, Telefónica and Hutchison signed an agreement for the acquisition by the latter of Telefónica's operations in the UK (O2 UK) for a price (firm value) of 10,250 million pounds sterling in cash (approximately 14,000 million euros at the exchange rate as of the date of the agreement), composed of (i) an initial amount of 9,250 million pounds sterling (approximately 12,640 million euros as of the date of the agreement) which would be paid at closing and (ii) an additional deferred payment of 1,000 million pounds sterling (approximately 1,360 million euros) to be paid once the cumulative cash flow of the combined company in the United Kingdom has reached an agreed threshold.

Completion of the transaction is subject to, among other conditions, the approval of the European Comission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties. As of the date of the issuance of these Financial Statements, such conditions had not been met. The European Commission authorization process is ongoing.

As completion of the share purchase agreement is conditional on the satisfaction (or, if applicable, waiver) of certain conditions, the acquisition may or may not proceed. If the abovementioned divestment is ultimately not consummated, or it is consummated under conditions other than those initially reported, this could have a material adverse effect on the trading price of Telefónica's ordinary shares, bonds and financial instruments, and its leverage.

Risks Relating to the Group's Industry

The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.

The telecommunications sector is subject to laws and regulations in different countries, and additionally, many of the services the Group provides require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to spectrum availability. Among the main risks of this nature are those related to spectrum regulation and licenses/concessions, rates, Universal Service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality.

Thus, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies' decisions, such as economic fines for serious breaches in the provision of services and, potentially, revocation or failure to renew these licenses, authorizations or concessions, or the granting of new licenses to competitors for the provisions of services in a specific market.

In this regard, the Telefónica Group pursues its license renewals in the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality, service and coverage standards and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession. Additionally, the Telefónica Group could be affected by regulatory actions carried out by the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses.

Moreover, the fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations. For example, regulations fix the rates that Telefónica charges for calls received from other companies' networks, and regulators have progressively lowered these rates in recent years. In addition, and particularly in Spain, regulators have promoted competition in recent years by, for example, adopting policies which allow alternative operators access to Telefónica's networks. This intense competition has exerted downward pressure on Telefónica's tariff structure, adversely affecting revenues, and led to increased commercial expenses, adversely affecting margins.

Regulation of spectrum and government licenses

Further to the European Commission's new "Digital Single Market" (DSM) Strategy, Europe is expected to undergo an important review of its regulatory framework. The new European DSM Strategy comprises a series of policy initiatives to promote the development of the single market of digital services and networks. As a result, the European Commission will initiate legislative processes, which could have significant implications on access to network, spectrum use, auction conditions, duration and renewal of licenses, audiovisual services and platforms, among other various matters.

On May 8, 2015, the European Commission approved a Decision on the harmonization of the 1452 - 1492 MHz frequency band (1500 MHz band), which encourages Member States to designate and to make available this band frequency from November 2015, on a non-exclusive basis. As a result, new spectrum award processes are expected in the short and mid-term all across the EU. Germany and the United Kingdom have already auctioned the band frequency and therefore the Decision will not have a material impact on Telefónica's cash flow in those markets. In Spain, the Government launched a consultation which ended on June 21, 2015 to evaluate demand for spectrum in the 1500 MHz band. The tender of the 1500 MHz band in Spain may take place during 2016.

Additionally, the main terms of the allocation and use of the 700 MHz band in Europe is expected to be decided in the coming months. This could require new cash outflows from Telefónica between 2018 and 2021 (the period over which it is expected that the spectrum will be available), except in Germany which was the first country in Europe to award spectrum in the 700 MHz band, together with the 1800 MHz, 900 MHz and 1500 MHz bands.

Further, in Germany, on July 4, 2014 and September 25, 2015, the German Federal Network Agency (BnetzA) adopted decisions concerning the impact of Telefónica Deutschland Holding AG merger with E-Plus Mobilfunk GmbH & Co. KG (E-Plus) on the spectrum held by Telefónica Deutschland (the surviving entity after the merger). BnetzA has required Telefónica Deutschland to terminate by June 30, 2016 (rather than December 31, 2016) some rights of use with respect to spectrum in the 1800 MHz band that was not reacquired by Telefónica Deutschland at the abovementioned auction proceeding. The remaining 1800 MHz spectrum band that was not reacquired in such auction was returned at the end of 2015. The German regulator also announced that it will perform a frequency distribution analysis, and determine whether any additional action is needed, particularly in the area of the 2 GHz spectrum band granted to Telefónica Deutschland.

United Internet and the regional cable operator Airdata have filed complaints against the EU General Court decision allowing the merger between Telefónica Deutschland Holding AG and E-Plus Mobilfunk GmbH & Co. Telefónica Deutschland has been accepted as an interested party in these proceedings.

In the United Kingdom, licenses were amended in January 2015 to introduce a 90% geographic coverage obligation for voice and text services. Separately, on September 24, 2015, the telecommunication regulator (Ofcom) issued a decision to increase the annual fees which mobile operators must pay for the use of 900 MHz and 1800 MHz spectrum. Accordingly, from October 31, 2015, the annual charge that Telefónica UK must pay is 32.2 million pounds sterling (increased from 15.6 million pounds sterling), rising to 48.7 million pounds sterling plus CPI from October 31, 2016. Finally, following consultation, on December 3, 2015 Ofcom published an update stating that it has decided to initiate an auction procedure to award 2.3 GHz and 3.4 GHz spectrum once decisions have been made by the relevant competition authorities, in relation to the proposed merger between Telefónica UK Limited and Hutchison 3G UK Limited.

In Latin America, spectrum auctions are expected to take place implying potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2016 are:

- Peru: In August 2015, the government published the conditions for granting licenses in the 700 MHz spectrum band (three blocks of 2x15 MHz have been defined). On November 4, 2015 Telefónica was declared as a prequalified bidder.
- Costa Rica: In December 2015, the Government communicated its intention to auction 40 MHz in the 1800 MHz band and 30 MHz in the 1900/2100 MHz band during 2016.
- Mexico: The Federal Telecommunications Institute (IFT) has proposed to auction spectrum in the 2500 MHz band in 2016. In addition, and in light of the constitutional reform resulting from the "Pact for Mexico" political initiative, a wholesale network offering services in the 700 MHz band will be created under a Public-Private Partnership (PPP). On January 29, 2016, the SCT (*Secretaría de Comunicaciones y Transportes*) published the rules for the International Competitive Tender. The rules state that the contract will be awarded in August 2016 and commercial operations must begin no later than March 31, 2018.
- Panama: On December 4, 2015, the process of reallocation of the AWS band (140 MHz, 1710-1780 / 2110-2180 MHz) was announced. It is expected to start by the end of 2016.
- Uruguay: The Government approved a resolution allowing for a spectrum auction for mobile services. The auction will contain 15 + 15 MHz in the “AWS Ext” spectrum band and 45 + 45 MHz in the 700 MHz spectrum band (20 + 20 MHz of the 45 + 45 MHz in 700 MHz were previously reserved for the National Telecommunications Administration, ANTEL). As of the date of this report, this process has been delayed and the bidding rules for spectrum have not yet been published.
- Colombia: The regulator has published a consultation document for comment which analyzes alternatives and other considerations regarding the structuring of the allocation process for radio spectrum in the 700 MHz bands (which is part of the “Digital dividend”, which is the set of frequencies that have been available to mobile communications services in the frequency bands traditionally used for television broadcast (700 MHz and 800 MHz) due to the migration from analogue TV to digital TV), 900 MHz, 1900 MHz and 2500 MHz for mobile services. The first auction is expected to take place in 2016. Colombia has established spectrum caps for lower bands, which are currently set at 30 MHz, and Telefónica has 25 MHz in lower bands.
- Venezuela: The regulator has indicated the possibility of awarding spectrum in the 2600 MHz band (20 + 20 MHz) for 4G services, in the 1900 MHz band (5 + 5 MHz) for 3G services and in the 900 MHz band during 2016.

In December 2015, the Brazilian regulatory authority (Agencia Nacional de Telecomunicações or ANATEL) auctioned the spectrum lots remaining in the 1800 MHz, 1900 MHz, 2500 MHz and 3500 MHz bands, where Telefónica acquired seven lots of 2.5 GHz frequency band. These lots are associated to six different States, five of them in the capital cities of the States of São Paulo, Rio de Janeiro, Porto Alegre, Florianápolis, and Palmas and one in an interior city of the State of Mato Grosso do Sul. Such frequencies will be used for provision of mobile broadband service on 4G.

Further to the above, certain administrations may not have announced their intention to release new spectrum and may do so during the year. The above does not include processes announced via general statements by administrations, which involve bands not key to Telefónica’s needs. Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

Risks relating to concessions and licenses previously granted

In the state of São Paulo, Telefónica Brazil provides local and national long-distance Commuted Fixed Telephony Service ("CFTS") under the public regime, through a concession agreement, which will be in force until 2025. In accordance with current regulations, Telefónica Brazil informed ANATEL that the net value as of December 31, 2015 of assets assigned to the provision of the CFTS (which include, among others, switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment) were estimated to total 7,856 million Brazilian reais. In principle, the assets assigned to the provision of the CFTS are considered reversible assets; the scope of such reversibility is subject to a complex debate at different instances.

On June 27, 2014, as established in the concession agreement, ANATEL issued a public consultation for the revision of the concession agreement. Although definitive conditions (which might deal, among others, with the reversibility of assets, universalization goals and, in general, the obligational regime of the concessionaire) were to be published in 2015, such publication was postponed until April 2016. In addition, current reversibility regulations will be reviewed by ANATEL, which is expected to issue a public consultation in the near future. Definitive regulations might be issued in the second half of 2016. We cannot assure that changes made to the concession terms or to the reversibility regulations will not be detrimental to Telefónica's interests.

In Colombia, the ICT Ministry issued Resolution 597 on March 27, 2014, to renew 850 MHz/1900 MHz licenses for 10 additional years. The reversion of assets (other than radio frequencies, which is clear that must be returned) and its scope, has been discussed in the context of the liquidation of the concession contract, taking into consideration the terms of the contract, and the Constitutional Court's review of Law 422 of 1998, and Law 1341 of 2009. Discussions on the matter concluded on February 16, 2016. The ITC Ministry has announced that it is going to convene the Arbitral Tribunal, in accordance with what was agreed upon in the concession contract. To date, the content of the claim is unknown.

In Peru, the concessions for the provision of the fixed-line service will remain in force until November 2027. However, the Company filed a partial renewal request for five more years in December 2013. As of the date of this Annual Report, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) is still pending.

Telefónica Móviles Chile, S.A. was awarded spectrum on the 700 MHz (2x10 MHz) band in March 2014. The claim brought by a consumer organization against 700 MHz assignments was rejected by the Court of Defense of Free Competition in a judgment of July 24, 2015 and the appeal before the Hon. Supreme Court submitted by the consumer organization is still awaiting resolution.

In El Salvador, the process of renewal of the Group's licenses, which expires in 2018, has been postponed.

In Ecuador, once the Group's concession for mobile services expires in 2023, the renewal of such concession or the granting of a new concession will be subject to negotiation with the Government. If the Group fails to renew such concession or obtain a new concession, assets assigned to the provision of mobile services will revert to the State in exchange for a fee.

The Group's consolidated investment in spectrum acquisitions and renewals in 2015 amounted to 1,585 million euros.

The Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above or any others in which it operates or its inability to assume the related costs, could have an adverse impact on its ability to launch and provide new services and on Telefónica's ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and cash flows.

Regulation of wholesale and retail charges

The European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. Under this regulation, from April 30, 2016, when its implementation becomes effective, until June 15, 2017 operators may charge users roaming within the EU an additional fee on their domestic prices for roaming calls, SMS and data services, subject to certain regulated limits. In particular, the surcharges allowed during this period are 0.05 euro/minute for calls, 0.02 euro per SMS sent and 0.05 euro per megabits data (excluding VAT). During this period, the sum of the domestic retail price and any such surcharge shall not exceed 0.19 euro/minute for calls, 0.06 euro per SMS sent and 0.20 euro per megabits data. However, surcharges will not be permitted from June 15, 2017 onwards. The impact of this measure is very difficult to quantify because it will depend on the elasticity of traffic to decreases in the rates charged.

The decreases in wholesale mobile network termination rates (MTR) in Europe are also noteworthy. In the United Kingdom, wholesale MTRs have been reduced to 0.680 ppm (pence/minute) from May 1, 2015 (representing a 19.5% reduction compared to the previous rates). Further cuts of 26.3% and 3.1% (in real terms) will come into effect in April 1, 2016, and April 1, 2017, respectively. However, the impact of these decreases in the Group's results will be diminished if the proposed sale of our operations in the United Kingdom to Hutchison is completed on a timely basis.

In Germany, on April 24, 2015, BNetzA adopted its final decisions to reduce MTRs. The new prices will gradually decrease from 0.0172 euro/minute to 0.0166 euro/minute from December 1, 2015 until the end of November 2016. The European Commission had beforehand requested that the German regulator withdraw or amend the proposal of such decision. Because BNetzA did not apply the "Pure LRIC (Long Run Incremental Cost Model)" approach recommended by the European Commission, there is a risk that the Commission will initiate infringement proceedings against Germany, and rates may be further reduced.

In Spain, the Spanish National Markets and Competition Commission (Comisión Nacional de los Mercados y la Competencia or CNMC) has initiated the process of reviewing the prices of mobile termination, with a final decision expected to be adopted in the second half of 2016. Additionally, in May 2015, the CNMC launched a public consultation on the analysis of the market for access and call origination on fixed networks. The CNMC proposes to maintain the obligation of Telefónica to provide a wholesale interconnection offer (RIO) and a wholesale offer of access to the fixed telephone line (WLR), both with cost-oriented prices. The final decision is expected to be issued during the first half of 2016.

In Latin America, it is likely that MTRs are also reduced in the short to medium term. For example, in Mexico, on October 1, 2015, the IFT adopted the MTR for 2016. The MTR was set at 0.1869 Mexican pesos per minute in consistency with the Pure LRIC model. The previous MTR was set at 0.2505 pesos per minute.

Telefónica has appealed this decision as well as other decisions concerning the MTR applicable from 2011 to 2015.

In Brazil, ANATEL has been issuing ex-ante regulations to ensure competition in the wholesale market which includes reductions of the MTR. In this regard, the "Plano Geral de Metas de Competição (PGMC), as amended by Resolution 649/2015, established that mobile termination fees are subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees shall be in force (such Resolution has been challenged in courts without a definitive outcome).

In Argentina, the new legal framework "Argentina Digital" provides the new regulator the possibility to regulate the tariffs and prices of essential public services, wholesale services and those the regulator determines based on reasons of public interest, on which the law does not set parameters. As a result, there may be a negative impact, depending on how the new regulator exercises its powers. In addition, until the Secretary of Communications determines that there is effective competition for telecommunications services, the "dominant" providers in the relevant areas (which include Telefónica de Argentina) must respect the maximum tariffs established in the general tariff structure.

Regulation of Universal Services

In September 2015, as a part of the DSM Strategy, the European Commission issued a public consultation on the review of the regulatory framework for electronic communications, including certain aspects of the Universal Service obligations. Depending on the outcome of this public consultation, the European Commission could initiate a legislative process including both the potential inclusion of certain broadband speeds in its scope and a possible reduction of some of the current Universal Service obligations that are becoming obsolete. Depending on the terms that will be set forth in the new regulation, implementation at a local level could lead to higher costs for both the Universal Service provider and the operators forced to finance the Universal Service.

In Spain, the licenses of Telefónica de España and Telefónica Telecomunicaciones Públicas (which owns public terminals) for the provision of Universal Services will expire on December 31, 2016. As from this date, there will be a new tender for the award of the provision of the Universal Services.

Regulation of fiber networks

On November 18, 2015 the Spanish CNMC adopted a Draft Resolution on the wholesale broadband market regulation, which foresees a geographical segmentation in competitive and non-competitive areas. This draft Resolution was approved by the European Commission on December 18, 2015. The new resulting regulation, which will apply to NGA (Next Generation Access Networks), could be approved in the first quarter of 2016 and will presumably last for at least three years. Its implementation is expected to result in an increase, of the current regulatory obligations of Telefónica in Spain, in terms of its granting of access to other operators to its fiber network and with respect to certain aspects relating specifically to the business segment.

Regulations on privacy

In Europe, a political agreement between the Council and the European Parliament was reached on December 15, 2015, on the new General Data Protection Regulation (GDPR) and the Data Protection Directive. Formal adoption of such regulation by both the Council and the Parliament is expected to take place in spring 2016. The GDPR would become effective two years thereafter, by spring 2018. Some of the critical provisions of this new Regulation will make tougher the launch of new services focused on the processing of personal data. In addition, the GDPR will introduce administrative fines of up to 4% of an undertaking's annual global turnover for breaching the new data protection rules.

In October 2015, the Court of Justice of the European Union declared invalid the Decision of the European Commission[4] of July 26, 2002, known as the “Safe Harbor Agreement”, relating to the transfer of personal data from the EU to the United States. Since November 2015, EU and US Authorities have been negotiating a new agreement that ensures a level of protection similar to that provided by the EU. Failure to reach this agreement would create difficulties in the provision of services which involve the flow of EU citizens’ personal data to the US.

In Brazil, it is expected, in the near future, that the Personal Data Protection Act will be adopted. This could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment. In Peru, on May 8, 2015, the new Personal Data Protection Law came into force. The adoption of secondary legislation is still pending. In Ecuador, the Telecommunications Act (Ley Orgánica de Telecomunicaciones), adopted in February 2015, devotes a whole chapter to regulate the use of personal data.

Regulation of functional separation

The principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operates could result in greater regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators (in specific cases and under exceptional conditions) forcing operators with significant market power and vertically-integrated operators to separate their wholesale and retail businesses at a functional level. They would therefore be required to offer equal wholesale terms to third-party operators that acquire these products.

Regulation of network neutrality[5]

As mentioned above, the European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. The regulation will enter into force on April 30, 2016. The application of the Regulation could directly affect possible future business models of Telefónica and may affect the network management or differentiation of characteristics and quality of Internet access service.

Telefónica operates in Latin American countries where net neutrality has already been ruled, such as Chile, Colombia, Brazil, Argentina, Mexico and Peru, where Osiptel published on September 8, 2015 the Draft Regulation on Net Neutrality. In Brazil, the Secretariat of Legislative Matters of the Ministry of Justice is concluding a proposal on Net Neutrality Regulation.

If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group’s international operations are subject to various anti-corruption laws, including the U.S. Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanction programs, including those administered by the United Nations, the European Union and the United States, including the U.S. Treasury Department’s Office of Foreign Assets Control. The anti-corruption laws generally prohibit providing anything of value to government officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group’s business, it may deal with entities, the employees of which are considered government officials. In addition, economic sanctions programs restrict the Group’s business dealings with certain sanctioned countries, individuals and entities.

[4] Commission Decision 2000/520/EC, of 26 July 2000 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequacy of the protection provided by the safe harbour privacy principles and related frequently asked questions issued by the US Department of Commerce.

[5] In general terms, it is a principle applicable to the field of Internet networks, for which operators may not place restrictions on the terminals that can be connected or the services, applications and content that can be distributed. It also refers to non-discrimination by operators between different types of traffic circulating through their networks.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption laws and sanctions regulations could lead to financial penalties, exclusion from government contracts, damage to our reputation and other consequences that could have a material adverse effect on the Group's business, results of operations and financial condition.

As at the date of this report, Telefónica is currently conducting an internal investigation regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about this matter and intends to cooperate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

The Company may not be able to adequately foresee and respond to technological changes and sector trends.

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

New products and technologies arise constantly, and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 1,012 million euros in 2015, representing a decrease of 0.9% from 1,021 million euros in 2014 (959 million euros in 2013). These expenses represented 2.1%, 2.3% and 1.9% of the Group's consolidated revenues in 2015, 2014 and 2013, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development (OECD) manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 100MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond the Company's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency.

The Company depends on its suppliers.

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets, with a high concentration in a small number of suppliers, poses risks that may affect the Company's operations, and may cause legal contingencies or damages to the Company's image in the event that inappropriate practices are produced by a participant in the supply chain.

As of December 31, 2015, the Telefónica Group depended on five handset suppliers and 13 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

Unanticipated network interruptions can lead to quality loss or the interruption of the service.

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses become increasingly dependent on telecommunications and computer networks and adopt cloud computing technologies. Cybersecurity threats include gaining unauthorized access to our systems or inserting computer viruses or malicious software in our systems to misappropriate consumer data and other sensitive information, corrupt our data or disrupt our operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, portable data devices and mobile phones and intelligence gathering on employees with access.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization (WHO), that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee (ICNIRP) have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may negatively affect the business, financial conditions, results of operations and cash flows of the Telefónica Group.

Possible regulatory, business, economic or political changes could lead to asset impairment.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairment in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. For example, with respect to the investment in Telco, S.p.A. (Telco), value adjustments were made in 2014 with a negative impact of 464 million euros.

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

Any of the foregoing could have an adverse impact on the business, financial position, results of operations and cash flows of the Group.

Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings.

Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and cash flows. In particular, the Telefónica Group is party to certain judicial tax proceedings in Peru concerning the clearance of certain previous years' income tax, in respect of which a contentious-administrative appeal is currently pending and to certain tax proceedings in Brazil, primarily relating to the CIMS (a Brazilian tax on telecommunication services). Further details on these matters are provided in Notes 17 and 20 of the Financial Statements.

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Translation of an auditor's report on the Internal Control over Financial Reporting originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails

AUDITOR'S REPORT ON THE INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors of
Telefónica, S.A., engaged by the management

We have examined the description of the Internal Control over Financial Reporting of Telefónica, S.A. (the Parent Company) and subsidiaries (the Group) included in Section F of the Annual Corporate Governance Report for the year ended December 31, 2015. This examination included the evaluation of the effectiveness of internal control over financial reporting with respect to the financial information included in the Group's consolidated financial statements at December 31, 2015, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group in Spain. Such internal control is based on the criteria and policies defined by the Parent Company's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its report "Internal Control - Integrated Framework" (2013).

Telefónica, S.A.'s management is responsible for maintaining effective internal control over financial reporting included in the consolidated financial statements, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the aforementioned effectiveness of internal control over financial reporting, based on the work we have performed in accordance with the requirements of the Standard ISAE 3000 "Assurance Engagement Other than Audits or Reviews of Historical Financial Information" issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) for the issuance of reports to obtain reasonable assurance.

The work performed to obtain reasonable assurance includes obtaining an understanding of the internal control over financial reporting with respect to the financial information included in the consolidated financial statements, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and Directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements, fraud or illegal acts. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Telefónica, S.A. and subsidiaries maintained, in all material respects, effective internal control over financial reporting with respect to the financial information included in the consolidated financial statements as of December 31, 2015, based on the criteria and policies defined by the Parent Company's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its report "Internal Control - Integrated Framework" (2013). We also have checked that the disclosures included in the accompanying description of the internal control over financial reporting at December 31, 2015 comply, in all material respects, with the requirements of the article 540 of the Spanish Companies Law, approved by Royal Legislative Decree 1/2010 of July 2, and meets the minimum content of the Annual Corporate Governance Report template required by Circular 7/2015, issued on December 22, 2015 by the Comisión Nacional del Mercado de Valores (Spanish stock market regulator).

The examination indicated in the preceding paragraphs is not subject to the Spanish Audit Law, approved by Royal Legislative Decree 1/2011 of July 1, so we do not express an audit opinion in the terms provided for in the aforementioned Law.

In addition to the aforementioned examination, we have audited, in accordance with prevailing audit regulations in Spain, the consolidated financial statements of Telefónica, S.A. and subsidiaries at December 31, 2015, prepared by the Parent Company's Directors in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group in Spain, and our report dated February 26, 2016 expressed an unqualified opinion on the aforementioned consolidated financial statements.

ERNST & YOUNG, S.L.

Viota

Ignacio Viota del Corte

February 26, 2016