

**REPORT OF THE NOMINATING, REMUNERATION AND CORPORATE
GOVERNANCE COMMITTEE OF TELEFÓNICA, S.A.**

IN RELATION WITH

**PROPOSED APPROVAL OF THE DIRECTORS' REMUNERATION POLICY
(ARTICLE 529 NOVODECIES OF THE SPANISH LAW ON CORPORATIONS)**

10 March 2021

1. INTRODUCTION

This report includes the proposal put forward by the Nominating, Remuneration and Corporate Governance Committee for the Directors' Remuneration Policy (hereinafter referred to as the "Policy") of Telefónica, S.A. (hereinafter referred to as "Telefónica" or the "Company"), which shall be in force, if approved, on the date it is approved by the General Shareholders' Meeting and remain in force until 31 December 2023, making the Remuneration Policy 2019-2021 currently in force null and void.

This report is made available to shareholders on Telefónica's website, as stipulated by Article 529 novodecies, of the redrafted text of the Spanish Law on Corporations (with initials in Spanish "LSC"). This article requires that all listed companies have in place a remuneration policy approved by the General Shareholders' Meeting at least every three years and that any remuneration paid to the Directors must be consistent with such remuneration policy.

At the General Shareholders' Meeting held on 8 June 2018, Telefónica submitted for approval a Directors' Remuneration Policy for a valid term encompassing 2019, 2020 and 2021. The Remuneration Policy has maintained the essential principles applied in the previous financial years and was approved by the General Shareholders' Meeting with 88.45% of the votes cast.

Bearing in mind the foregoing, the Nominating, Remuneration and Corporate Governance Committee will submit a new Policy for approval which, if approved by the General Shareholders' Meeting, will be applicable since the date such General Shareholders' Meeting is held and remain in force until 31 December 2023.

2. PRINCIPLES OF THE DIRECTORS' POLICY

The general principles underpinning the Policy are the following:

		Executive Directors	Non-Executive Directors
Value creation	Alignment with the shareholders' interests and the aim of sustainably creating value over time.	●	
Pay for Performance	A significant part of the total remuneration for the Executive Directors is variable and receiving it is subject to achieving financial, business, value creation and ESG objectives that are predetermined, specific, quantifiable and aligned with the Company's corporate plan.	●	
Flexibility	The variable remuneration is not guaranteed and is sufficiently flexible so that there is a possibility of not paying this component.	●	
Competitiveness	In order to ensure the Company has the best professionals on board, the remuneration package must be competitive, both in its structure and its overall amount, with respect to other comparable companies at an international level.	●	●
Good Governance	When determining the remuneration for the Directors, the Company takes into consideration the developments taking place in regulations, best practices and national and international recommendations and trends related to the remuneration of Directors of companies listed on the stock market.	●	●
Fair Pay	The professional value, experience, time spent and responsibility of each director is sufficiently remunerated, ensuring that the remuneration policies and practices guarantee there is no discrimination for any reason (among others, due to gender, age, culture, religion and/or race).	●	●
Suitability	The amounts are sufficient to remunerate the qualifications, time spent and responsibility of the Directors, guaranteeing their required loyalty and allegiance to the Company, without compromising the independence of the Non-Executive Directors.		●
Transparency	The level of transparency in relation to remuneration is in line with the best corporate governance practices in order to create trust among all the stakeholders, including shareholders and investors.	●	●

3. SUMMARY OF THE NEW ASPECTS INTRODUCED IN THE NEW POLICY WITH RESPECT TO THE 2019-2021 REMUNERATION POLICY

Telefónica has carried out a process of reflection regarding the 2019-2021 Remuneration Policy, in which both internal and external factors have been considered:

- **Internal factors:** short- and long-term objectives, the results achieved by the Group, the link to the Strategic Plan and sustainability, as well as its alignment with the general remuneration policy for the Company's employees.
- **External factors:** recommendations received in the engagement process that Telefónica regularly conducts with investors, shareholders and proxy advisors, market practices of relevant companies for Telefónica due to being competitors for business or talent and companies considered high performers, and general corporate governance recommendations at a national and international level.

After completing such analysis, according to a proposal made by the Nominating, Compensation and Corporate Governance Committee, the Board of Directors plans to submit a new Policy for the approval of the Ordinary General Shareholders' Meeting in 2021.

The proposed new Policy is a continuation of the Remuneration Policy in force, even though it includes some adjustments that enable the improvement of the alignment with the strategic priorities of Telefónica, the opinion of investors and the good governance recommendations. The contents required according to Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement has also been taken into consideration in the development of this Policy.

The main changes proposed in the new Policy regarding Executive Directors are summarised below:

Fixed components

No changes are proposed either to the amounts or characteristics of the fixed elements.

Short-Term Variable Remuneration

No changes are proposed to the Short-Term Variable Remuneration.

Long-Term Variable Remuneration

Concept	Proposed amendment	Rational
Retention period	<p>The current Remuneration Policy sets that at least 25% of the shares that are awarded will be subject to a retention period of no less than one year.</p> <p>It is proposed that 100% of the shares that are awarded will be subject to a retention period of 2 years, which will be extended to 3 years until the number of shares subject to the permanent shareholding commitment has not been reached.</p>	<ul style="list-style-type: none"> • To strengthen the Executive Directors' long-term commitment to the Company. • Alignment with shareholder interests. • Alignment with best corporate governance and market practices.

Other elements of the Policy

Concept	Proposed amendment	Rational
Performance evaluation and extraordinary remuneration	<p>In relation to the determination of the target achievement level linked to the variable remuneration, the current Policy sets that any positive or negative economic effects caused by extraordinary events that could distort the results of the assessment are disregarded.</p> <p>The new Policy includes, in addition to the above provision, some examples of extraordinary events that could lead to an introduction of adjustments in the assessment of results.</p> <p>Moreover, the possibility is included for the Board of Directors, according to a proposal made by the Committee, to be authorised to agree on granting extraordinary remuneration to the Executive Directors and/or Senior Management (non-Directors) as compensation for their effort and special dedication to achieving certain strategic targets of the company, such as, for example, success in certain corporate reorganisation transactions, providing they create considerable added value for the Company's shareholders and/or create a significant economic profit or equity increase that enhances Telefónica's long-term sustainability and growth.</p> <p>The maximum amount of this extraordinary variable remuneration is limited to 100% of the annual fixed remuneration and in no case may increase the maximum total remuneration allocated to Executive Directors set in this Policy, that remains unchanged with respect to the Policy approved in 2018.</p>	<ul style="list-style-type: none"> • To adjust the remuneration to the Company's actual performance, beyond the formula that determines the variable remuneration amount. • Implementing Telefónica's strategy implies performing corporate transactions related to the various business activities of the Company. Such transactions are essential to create value for our shareholders and they involve tremendous effort and dedication from the team involved. We aim to have an opportunity where value creation across Telefónica's various business activities is rewarded.
Commitment to hold shares on a permanent basis	<p>The same commitment is maintained (two years' gross fixed remuneration); however, it is specified that, until this threshold is not reached, any shares, if any, received within the scope of any variable remuneration scheme must be held for at least 3 years.</p> <p>It also states that this requirement will be monitored by the Nominating, Compensation and Corporate Governance Committee.</p>	<ul style="list-style-type: none"> • Maintenance of the Executive Directors' long-term commitment specified in the previous Remuneration Policy. • Alignment with the new recommendation 62 of the Good Governance Code, published in June 2020.

Other elements of the Policy		
Concept	Proposed amendment	Rational
<p>Malus and clawback clauses</p>	<p>The current Remuneration Policy already allow the Nominating, Compensation and Corporate Governance Committee to propose full or partial cancellation of the payment of the Executive Directors' Short-Term Variable Remuneration to the Board of Directors under certain circumstances.</p> <p>The new Policy includes a standardisation of the malus and clawback clauses, which are applicable to any variable remuneration component. In this respect, the possibility is included to (i) partially or fully cancel the variable remuneration pending payment (malus) and/or (ii) partially or fully recover any variable remuneration component within 24 months after payment thereof (clawback), when certain exceptional situations arise that affect the Company's results or are related to the Executive Director's inappropriate conduct.</p> <p>Section 3.7 of the Policy outlines some of the situations in which these clauses may be applicable.</p>	<ul style="list-style-type: none"> • Commitment of Telefónica to designing a remuneration policy that is in line with prudent risk management. • Alignment with best corporate governance and market practices.

4. VALIDITY

The Policy will enter into force on the date it is approved by the General Shareholders' Meeting and remain in force until 31 December 2023, notwithstanding any amendments or updates that, where appropriate, the Board of Directors carries out in accordance with the provisions thereof, and any amendments that may be approved by the General Shareholders' Meeting of Telefónica from time to time.