3.1. Risk management and control model

3.1.1.Introduction and reference frameworks

Telefonica has a Risk Management Framework, based on the model established by the Committee of Sponsoring Organizations of the Treadway Commision (COSO), that allows both the identification and the assessment of the impact and the likelihood of occurrence of the different risks of the Company. This framework has been implemented homogeneously throughout the Group's main operations, and those responsible for the Company, in their field of activity, carry out the appropriate identification, evaluation, response and monitoring of the main risks.

This model, which is inspired by best practices, facilitates the prioritization and development of coordinated actions against risks, both from a global Group perspective, and a specific focus on its main operations.

The Telefónica's Business Principles specifically state that:

" We establish appropriate controls to evaluate and manage all relevant risks to the Company"

Extract from Responsible Business Principles of Telefónica

In this sense, the Company has a **Risk Management Policy**, approved by the Board of Directors, and a **Corporate Risk Management Manual**, both based on experience, best practices and Good Corporate Governance recommendations; contributing to the continuous improvement in business performance, according to COSO ERM 2017 framework, "Enterprise Risk Management - Integrating with Strategy and Performance".

"The main risks are linked to the strategic objectives of the Company Program"

Enterprise Risk Management (ERM)

COSO ERM Framework

Risk Culture

In accordance with Telefónica's Risk Management Policy, one of the basic principles that guide this activity is: "Train and involve employees in the risk management culture, encouraging them to identify risks and actively participate in its mitigation."

In this sense, Telefonica promotes the following actions:

- Communication: in order to spread, through the appropriate channels, the principles and values that should govern risk management.
- Training: to promote knowledge and involvement in the aforementioned values and risk management model.

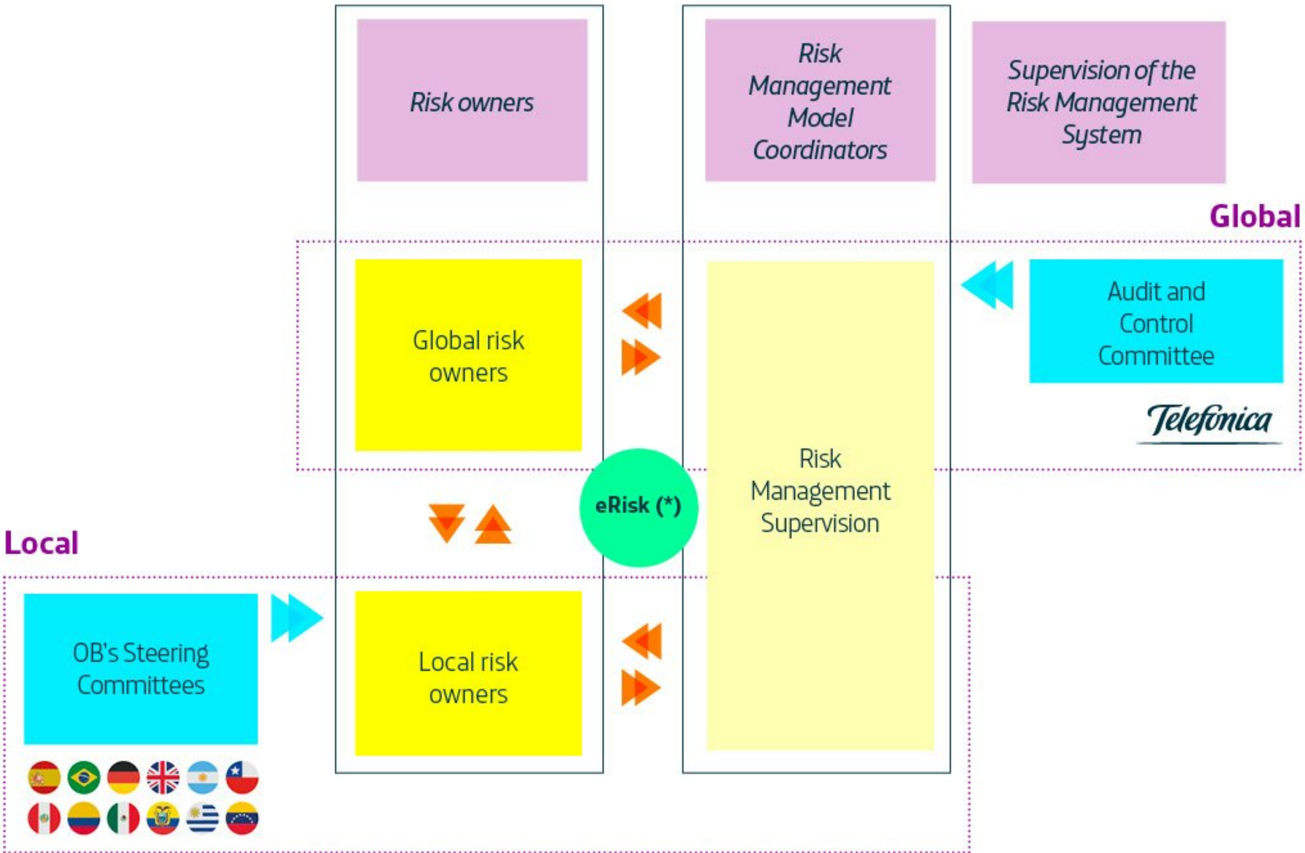
"Training workshops and global awareness campaigns are developed to strengthen the risk management culture in the Company"

Risk culture

3.1.2. Risk Management Government

Both the Telefonica's Business Principles and the Risk Management Policy mentioned above, establish that the entire organization has the responsibility to contribute to the identification and management of risks. For the coordination of these activities, the following roles have been established:

Risk Management Government



(*) Internal risk management tool

Supervision of the Risk management system

The Board of Directors Regulations of Telefónica, SA, establish that the Audit and Control Committee shall have the primary function of supporting the Board of Directors in its supervisory functions; among which, is included the Supervision of Control Systems and Risk Management, including tax risks. In relation to this, it is up to propose to the Board of Directors the Management Policy and Risk Management, which will identify, at least: the risk categories that the company faces; the determination of the level of risk that the Company considers acceptable; the measures to mitigate the impact of the identified risks in case they materialize; and the control and information systems that will be used to control and manage the aforementioned risks.

As a support for the development of these oversight activities by the Audit and Control Committee, a risk management function has been established, within the Internal Audit area, independent of the management, in order to promote, support, coordinate and monitor the implementation of the provisions of this Policy both at Group level and in its main operations.

For the purpose of ensuring an adequate supervision of the Telefónica'srisk management systems by the Audit and Control Committee, various sessions are held within that committee, through:

- **Overall presentations** on the risk management model and the situation of the main risks, carried out by Internal Audit, where the general situation of the Group'srisks is presented, as well as its evolution, general plans on risk assessment and response. Specifically, during 2019, two general presentations on risks have been made to the Audit and Control Committee of Telefónica.

- **Specific presentations** of the main risk areas made by those responsible for their management. . Thus, during 2019, monographic sessions have been made on the risks of Systems and Network, Regulation, Sustainability, People, Digital Security, Fiscal, Financial, Legal and Compliance.

Likewise, the Audit and Control Committee periodically reports on these matters to the Board of Directors.

Risk Owner
Risk owners actively participate in the risk strategy and in the important decisions about their assurance and control. To this end, each of the identified risks will be assigned a person (normally a Director) in charge with total responsibility for the risk and its management, preparing a plan for its assurance and control (measures to avoid, mitigate or partially transfer the risks) and effectively tracking its evolution.

Specifically, with respect to fiscal risks, the Group's Fiscal Directorate performs the fiscal control function through the Regional Fiscal Directorates, and the local fiscal control officers in the different subsidiaries in accordance with the principles defined in the Group's Fiscal Control Policy, approved by the Company's Board of Directors.

3.1.3.Tolerance or risk apetite
The Company has a level of risk tolerance or acceptable risk established at corporate level; which means its willingness to assume a certain level of risk, to the extent that allows the creation of value and the development of the business, achieving an adequate balance between growth, yield and risk.

For the risk assessment, the different typology of the risks that could affect the Company is considered, as described below:

- In general, **tolerance thresholds** are defined for all risks, by combination of impact and probability, whose scales are updated annually based on the evolution of the main financial figures, both for the Group as a whole and for the main companies that compose it.

- In the case of risks related to reputation, sustainability and compliance, a **zero tolerance** level is established.

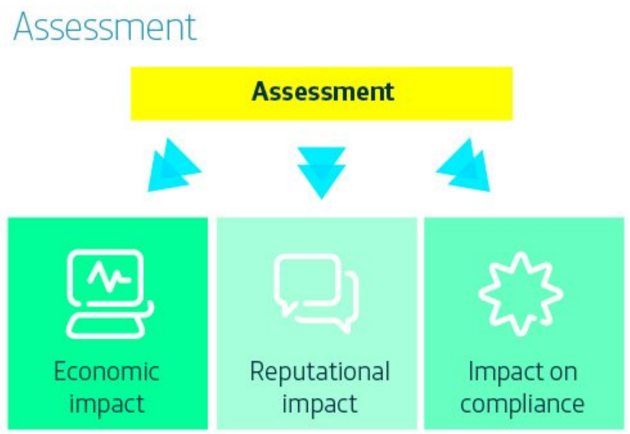
3.1.4. Risk management process
The risk management process takes the Company's strategy and objectives as a reference for the identification of the main risks that could affect its achievement. The process consists of four stages which are described below:

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

In this identification of risks, risks associated with the strategic plan are considered, as well as potential "emerging risks", meaning those risks that could eventually have an adverse impact on future performance; although its result and time horizon is uncertain and difficult to predict.

Risk Assessment
The objective of the risk assessment is to establish the magnitude or relevance of risks, by considering both their eventual impact and their likelihood of occurrence.

For impact purposes, both the **economic impact** (quantified - whenever possible - in terms of operational Cash-flow, considering OIBDA plus CAPEX) and the **reputational impact** (from the variables used in RepTrak) are considered, as well as its potential **impact on compliance**.



Likewise, other qualitative additional factors are considered, such as the historical trend, the level of assurance or control; or the perspectives on their future evolution.

Risk Response

In addition to identification and assessment of the risks, the Risk Management Model considers reasonable response and monitoring mechanisms for said risks. In this sense, it contemplates procedures to respond to the new challenges that arise through the alignment between the strategic objectives and the risks that could affect the fulfillment of such objectives.

The different types of risk response are described below:

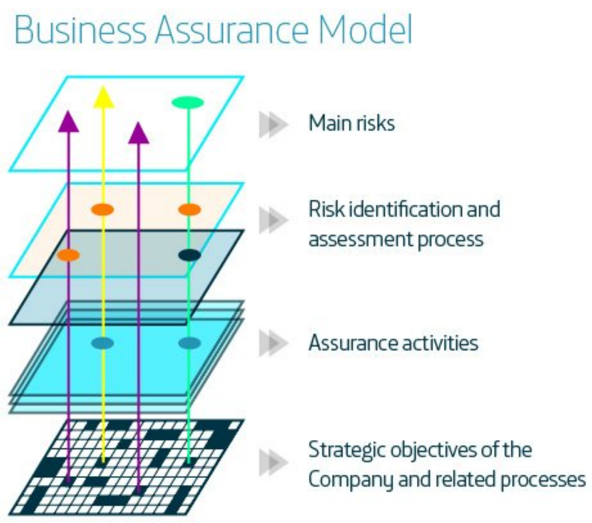
Global measures, mainly involving the use of financial derivatives, are undertaken to mitigate certain financial risks such as those relating to exchange-rate and interest-rate fluctuations. In relation to tax risks, the main issues are identified are monitored. The Group uses Multinational insurance Programs, or insurance policies arranged locally in each country, to cover operational risks, depending on the type of risk and cover required.

Monitoring and Reporting

In accordance with the diversity of the types of risk that may arise, the risk monitoring and response mechanisms include global initiatives, homogeneously promoted and coordinated throughout our main operations, and/or specific actions aimed at addressing particular risks in some of our companies.

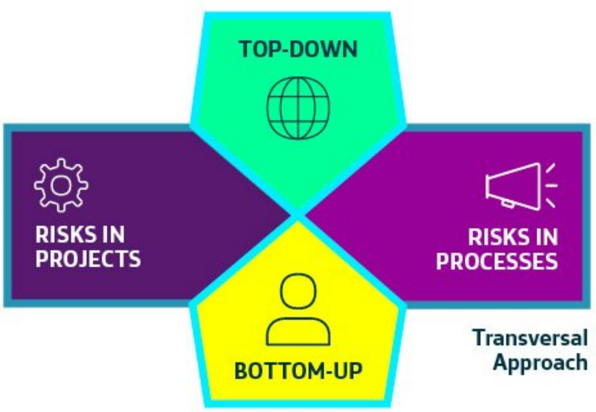
Business Assurance Model

A management model based on the existing assurance allows prioritizing and being more specific in the actions to be carried out in the area of Risk Management and Internal Control.



3.1.5 Perspectives of the Risk Management Framework

To have a comprehensive model, oriented to the needs and the Group's own configuration, the ERM Framework considers a **risk assessment through four complementary perspectives**:



Bottom-up: it is based on the concept of Risk Self-Assessment (RSA), according to which managers are responsible for identifying and describing the specific risks of their area, as well as assessing them and defining an adequate response to them.

Top-down: this assessment is based on the cross-sectional analysis of those matters considered relevant and common to most of the Group's companies, complementing the previous bottom-up approach, thus having a global vision of the main risks of the Company as a whole.

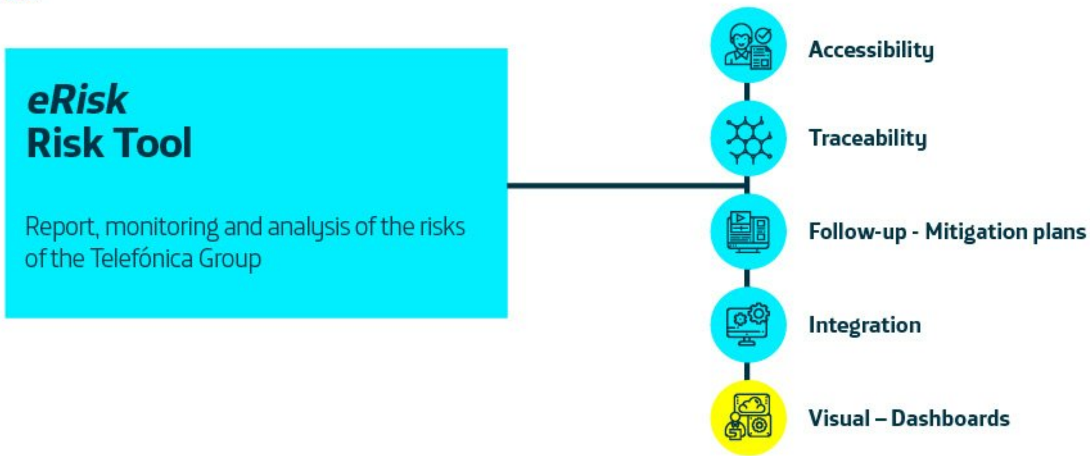
Risks in Processes: support to process managers to identify and define their response to those risks that may affect the achievement of their objectives, with a transversal approach.

Project Risks: applicable to those internal projects of special relevance, usually related to transformation initiatives and with a transversal approach.

3.1.6. Digitalization of risk management

With the aim of managing and supervising risks, a Risk Management tool and a Dashboard have been developed, which facilitate the reporting, analysis, assessment and management of risk information withinTelefónica Group. These tools are common for all Group Companies that report risks, and their main features are as follows:

eRisk

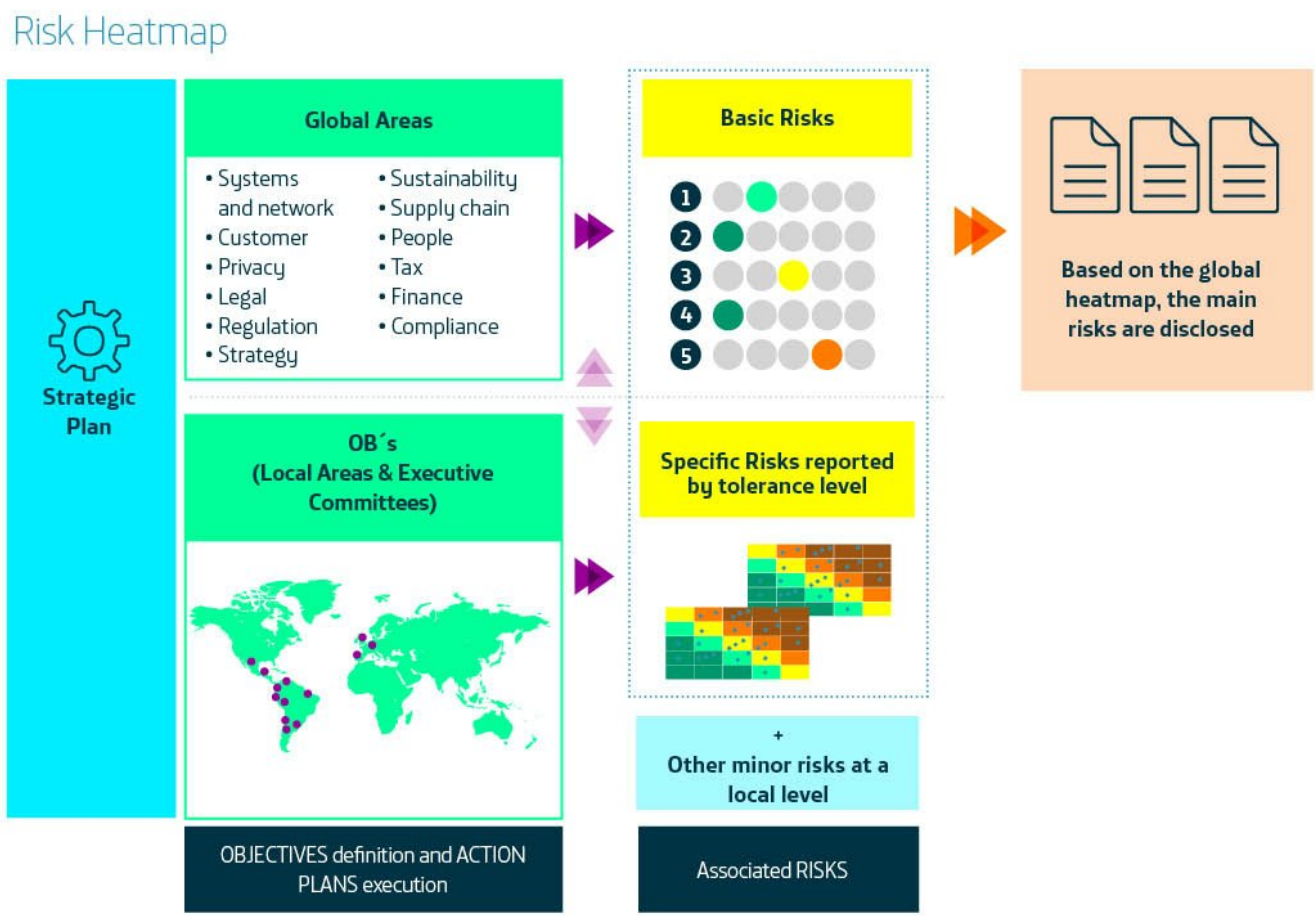


Digitalization of risk management

3.2. Risk map and risk profile

Taking as a reference the objectives identified in the Company's Strategic Plan, those risks that could affect the achievement of these objectives are identified, both from a global perspective (through the main global Group areas) and a local one (through local managers and the respective local Executive Committees).

An assessment of the impact and probability of the identified risks is made, which facilitates their prioritization and the definition of response plans to mitigate them, ensuring the necessary coordination between global and local initiatives in order to act against the risks.



In order to facilitate the risk identification process by the management of the Company, the Telefónica Group has a **general risks catalogue**, which is updated periodically, and which allows the information to be homogenized and consolidated, and to comply with the internal and external reporting requirements on the main risks.

Telefónica's risk catalogue considers the following four risk **categories:**

Risk categories

BUSINESS

Possible loss of value or results arising from the competitive situation, innovation, regulatory framework, as well as events that may affect the sustainability and reputation of the company.

OPERATIONAL

Possible loss of value or results as a result of events caused by inadequacies or failures in the network or the IT systems, security, customer service, human resources, as well as operational management.

FINANCIAL

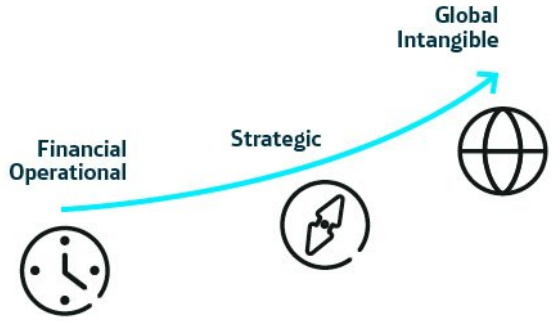
Possible loss of value or results arising from adverse movements in the economic environment or financial variables, and the Company's inability to meet its commitments or make its assets liquid. Risks of a fiscal nature are also included in this category.

LEGAL AND OF NORMATIVE COMPLIANCE

Possible losses of value or results arising from legal or compliance related issues.

This catalogue adapts to the **evolution in the typology of the main risks**, revealing a growing relevance of those risks related to intangibles and of global transcendence, such as public image, social impact of organizations or sustainability

Evolution of the main risks



Among the **main risks related to reputation, sustainability and the long term**, in accordance with the Responsible Business Plan of Telefónica, are the following aspects:

Risks related to reputation, sustainability and the long term

Environmental and electromagnetic fields

Direct or indirect impact on Telefónica's operations due to environmental issues in order to ensure alignment with the new environmental regulations.

Climate change

Risk of direct or indirect affectation to Telefónica's operations and business lines due to the consequences of climate change.

Human rights

Integrate human rights principles into the activity of the company or our supply chain.

Responsibility with the Consumer

The Company's actions, concerning our customers, should be aimed at building a sustainable relationship in the long term with them.

Data Privacy

Growing concern about citizens' privacy, and new data protection regulations, mean obligations for companies to strengthen their privacy guarantees.

Digital Segurity

Risk that potential cyber threats affecting the organization materialize, causing damage to the business.

In the same way, among the main **emerging issues**, it is worth highlighting issues related to People management, including aspects such as **diversity or professional skills management**, in line with what is described below:

Emerging issues: diversity and professional skills management

Diversity Management

Need to adapt the commitment to diversity, as a key lever towards digital transformation, guaranteeing multiculturalism, the variety of gender, age, profiles with different capacities and experiences among our professionals.

Skills Management for the future

Need to acquire and evolve the necessary capacities to execute the strategic plan of the Company, in an environment of technological disruption and shortage of critical skills in the market.

The strategy and management of the Telefónica Group's activities tend to minimize the impact of the **materialized risks,** as well as to counterbalance the negative effects of some issues with the favourable evolution of others.

In accordance with current accounting standards, the Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the need to introduce changes to the book value of its goodwill, intangible assets, property, plant and equipment or other assets. By way of example, in 2019, impairment losses in the goodwill allocated to Telefónica Argentina were recognized for a total of 206 million euros, due to factors such as the country's delicate financial situation or the deteriorating economic activity, which have strained the financial variables and a business plan that involves moderation in cash generation, compared to previous years.

In addition, Telefónica may not be able to realize deferred tax assets on its statement of financial position to offset future taxable income. By way of example, in 2019, Telefónica Móviles Mexico derecognized deferred tax assets amounting to 454 million euros.

3.2.1. Prioritization of Risks

The risks of Telefónica Group are prioritized based on their level of criticality, which is obtained from the combination of impact and likelihood assessments for each of them.

The detail on the main risks disclosed by the Company is included in the following section.

Priorization of risks

Risk heatmap

1. **Competition** and **market consolidation**.
2. **Data privacy**.
3. **Government concessions, licenses and use of spectrum**.
4. **Technological changes**.
5. Adaptation to changing **customer demands** and / or new **ethical or social standards**.
6. Dependency on **suppliers**.
7. **Cybersecurity** risks.
8. Unanticipated network interruptions can lead to **quality loss or the interruption of the service**.
9. **Economic and political environment.**
10. Possible **asset impairment** (goodwill, deferred tax or other assets).
11. Level of **financial indebtedness** and **Group's ability to finance.**
12. Foreign **currency exchange** rates and **interest rates**.
13. **Lawsuits, antitrust, tax claims** and other legal proceedings.
14. **Compliance with anti-corruption laws** and regulations and **economic sanctions programmes.**