

# Annual Corporate Governance Report for Listed Companies

## A. Capital Structure

### A.1 Complete the table below with details of the share capital of the company:

Date of last change	Share capital (€)	Number of shares	Number of voting rights
20/09/2017	5,192,131,686.00	5,192,131,686	5,192,131,686

### Please state whether there are different classes of shares with different associated rights:

No

### A.2 Please provide details of the company's significant direct and indirect shareholders at year end, excluding any directors:

Name or corporate name of shareholder	% of shares carrying voting rights		% of voting rights through financial instruments		% of total voting rights
	Direct	Indirect	Direct	Indirect	
Banco Bilbao Vizcaya Argentaria, S.A	5.26	0.01	0.00	0.00	5.28
CaixaBank, S.A	5.00	0.01	0.00	0.00	5.01
BlackRock, Inc.	0.00	4.85	0.00	0.22	5.08

**Breakdown of the indirect holding:**

Name or corporate name of indirect shareholder	Name or corporate name of direct shareholder	% of shares carrying voting rights	% of voting rights through financial instruments	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Seguros, S.A. de Seguros y Reaseguros	0.01	0.00	0.01
CaixaBank, S.A.	VidaCaixa, S.A. de Seguros y Reaseguros	0.01	0.00	0.01
BlackRock, Inc.	Grupo BlackRock	4.85	0.22	5.08

**Indicate the most significant movements in the shareholding structure during the year:**

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**A.3 In the following tables, list the members of the Board of Directors (hereinafter directors) with voting rights in the company:**

Name of director	% of shares carrying voting rights		% of voting rights through financial instruments		% of total voting rights	% voting rights that can be transmitted through financial instruments	
	Direct	Indirect	Direct	Indirect		Direct	Indirect
Mr. José María Álvarez-Pallete López	0.03%	0.00%	0.01%	0.00%	0.03%	0.00%	0.00%
Mr. Isidro Fainé Casas	0.01%	0.00%	0.00%	0.00%	0.01%	0.00%	0.00%
Mr. José María Abril Pérez	0.01%	0.01%	0.00%	0.00%	0.01%	0.00%	0.00%
Mr. Ángel Vilá Boix	0.01%	0.00%	0.01%	0.00%	0.01%	0.00%	0.00%
Mr. José Javier Echenique Landiribar	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Peter Erskine	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Luiz Fernando Furlán	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Ms. Carmen García de Andrés	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Ms. Maria Luisa Garcia Blanco	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Peter Löscher	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Ignacio Moreno Martínez	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Francisco Javier de Paz Mancho	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Francisco José Riberas Mera	0.00%	0.05%	0.00%	0.00%	0.05%	0.00%	0.00%

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**Total percentage of voting rights held by the board of directors**

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0.13%

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**Breakdown of indirect holding:**

Name of director	Name of direct shareholder	% of shares carrying voting rights	% of voting rights through financial instruments	% of total voting rights	% voting rights that can be transmitted through financial instruments
Mr. José María Abril Pérez	Other company shareholders	0.01%	0.00%	0.01%	0.00%
Mr. José Javier Echenique Landiribar	Other company shareholders	0.00%	0.00%	0.00%	0.00%
Mr. Francisco José Riberas Mera	Other company shareholders	0.05%	0.00%	0.05%	0.00%

**Remarks**

It is pointed out that the Company has, among its rules of governance, an Internal Code of Conduct in matters relating to the Securities Markets, which include, among other matters, the action rules for the performance of personal transactions by Directors and management personnel on securities issued by Telefónica, S.A. and financial instruments and contracts whose underlying are securities or instruments issued by the Company.

The general operating principles of such Internal Code of Conduct include operations subject to communication; action limitations; as well as the minimum maintenance period in the event of acquisition Company Shares, during which they shall not be transferred, unless there are exceptional situations that justify their transfer, with the prior authorization of the Regulatory Compliance Committee.

**A.4 If applicable, state any family, commercial, contractual or corporate relationships that exist among significant shareholders to the extent that they are known to the company, unless they are insignificant or arise in the ordinary course of business, except those that are reported in Section A.6:**

Name of related party	Nature of relationship	Brief description
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**A.5 If applicable, state any commercial, contractual or corporate relationships that exist between significant shareholders and the company and/or group, unless they are insignificant or arise in the ordinary course of business:**

Name of related party	Nature 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., Telefónica Factoring Perú, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., and Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Ciérvana, S.L. (a company which belongs to Grupo BBVA), together with Telefónica Compras Electrónicas, S.L.U., in Adquira España, S.A.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of BBVA Bancomer, Institución de Banca Múltiple, Grupo Financiero Bancomer (subsidiary of Banco Bilbao Vizcaya Argentaria, S.A.) together with Telefónica Móviles México, S.A. de C.V. (subsidiary of Telefónica, S.A.) in Adquira de México, S.A. de C.V.
Banco Bilbao Vizcaya Argentaria, S.A.	Contractual	Memorandum of understanding executed by Telefónica Digital España, S.L.U. with the aim of exploring a potential collaboration to offer loans to consumers and SME in Argentina, Colombia, Perú and México.
CaixaBank, S.A.	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., Telefónica Factoring Perú, 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.
CaixaBank, S.A.	Corporate	Shareholding of Caixabank Consumer Finance, E.F.C., S.A. (subsidiary of CaixaBank, S.A.) together with Telefónica, S.A., in Telefónica Consumer Finance, E.F.C., S.A.

**A.6 Describe the relationships, unless insignificant for the two parties, that exist between significant shareholders or shareholders represented on the Board and directors, or their representatives in the case of proprietary directors.**

Explain, as the case may be, how the significant shareholders are represented. Specifically, state those directors appointed to represent significant shareholders, those whose appointment was proposed by significant shareholders and/or companies in its group, specifying the nature of such relationships or ties. In particular, mention the existence, identity and post of directors, or their representatives, as the case may be, of the listed company, who are, in turn, members of the Board of Directors or their representatives of companies that hold significant shareholdings in the listed company or in group companies of these significant shareholders.

Name or company name of related director or representative	Name of company name of related significant shareholder	Company name of the group company of the significant shareholder	Description of relationship/post
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Banco Bilbao Vizcaya Argentaria, S.A.	In process of retirement. Formerly General Manager of Wholesale and Investment Banking in Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Isidro Fainé Casas	CaixaBank, S.A.	CaixaBank, S.A.	-
Ms. Sabina Fluxà Thienemann	Banco Bilbao Vizcaya Argentaria, S.A.	Banco Bilbao Vizcaya Argentaria, S.A.	Member of Eastern Territorial Regional Advisory Board (Spain) of Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Jordi Gual Solé	CaixaBank, S.A.	CaixaBank, S.A.	Chairman of CaixaBank, S.A.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office in Banco Bilbao Vizcaya Argentaria, S.A.

Remarks
<p><u>Mr. José María Abril Pérez and Mr. Ignacio Moreno Martínez</u> Name or company name of the shareholder represented or that has proposed their appointment: Banco Bilbao Vizcaya Argentaria, S.A.</p>
<p><u>Mr. Isidro Fainé Casas and Mr. Jordi Gual Solé</u> Name or company name of the shareholder represented or that has proposed their appointment: CaixaBank, S.A.</p>
<p><u>Ms. Sabina Fluxà Thienemann</u> Member of the Eastern Territorial Regional Advisory Board (which includes the regions of Valencia, Murcia and Baleares) of Banco Bilbao Vizcaya, S.A., to whom she advises as prominent businesswoman on their objective to keep on approaching their business strategy to the current social-economic situation of such regions, without receiving any remuneration for such position.</p>

**A.7 State whether the company has been notified of any shareholders' agreements that may affect it, in accordance with Articles 530 and 531 of the Ley de Sociedades de Capital (Corporate Enterprises Act or LSC). If so, describe these agreements and list the party shareholders:**

No

**State whether the company is aware of any concerted actions among its shareholders. If so, provide a brief description:**

No

**If any of the aforementioned agreements or concerted actions have been modified or terminated during the year, please specify expressly:**

Shareholders Agreement Telefónica, S.A. - Vivendi, S.A.

In September 2015, after obtaining regulatory approval from the Conselho Administrativo (Administrative Council) de Defesa Econômica (CADE), Telefónica, S.A. delivered to Vivendi, S.A. 46.0 million shares of its treasury stock, representing, at that time, 0.95% of its share capital, in exchange for 58.4 million shares of Telefónica Brasil, S.A. (received by Vivendi, S.A. in the framework of the acquisition of GVT Participações, S.A.) representing approximately 3.5% of the capital stock of Telefónica Brasil, S.A.

By virtue of this agreement, Vivendi, S.A. undertook, among other obligations, to: (i) refrain from selling Telefónica shares during certain periods (lock up), and to (ii) assume certain restrictions which, in the event of a transfer, after the lock up periods have elapsed, guarantee an orderly sale of such shares.

At the date of issue of this Report such shareholders agreement is no longer in force.

**A.8 State whether any individual or company exercises or may exercise control over the company in accordance with Article 5 of the Ley de Mercados de Valores (Spanish Securities Market Act or LMV). If so, please identify them:**

No

**A.9 Complete the following table with details of the company's treasury shares:**

At close of the year:

Number of direct shares	Number of indirect shares (*)	Total percentage of share capital
65,496,120	0	1.26 %

(\*) Through:

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Explain any significant changes during the year:

**Explain significant changes**

There is not significant change of the treasury stock in 2018. There have been only transmissions corresponding to the execution of different incentive plans for employees, which represent less than 0,01% of the stock.

**A.10 Provide a detailed description of the conditions and terms of the authority given to the Board of Directors to issue, repurchase, or dispose of treasury shares.**

At Telefónica's Ordinary General Shareholders Meeting held on June 8, 2018, the shareholders resolved to renew the authorization granted at the General Shareholders Meeting of May 30, 2014, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

"A) To authorize, pursuant to the provisions of Section 144 et seq., of the Spanish Companies Act (Ley de Sociedades de Capital), the derivative acquisition by Telefónica, S.A. -either directly or through any of the subsidiaries - at any time and as many times as it deems appropriate, of its own fully-paid in shares through purchase and sale, exchange or any other legal transaction.

*The minimum acquisition price or minimum value consideration shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or maximum value consideration 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 any of its 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 their option rights, 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 authorization 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 V on the Agenda by the shareholders at the Ordinary General Shareholders Meeting of the Company on May 30, 2014 ".*

#### A.11 Estimated working capital:

	%
Estimated working capital	83.24

**A.12 State whether there are any restrictions (article of associations, legislative or of any other nature) placed on the transfer of shares and/or any restrictions on voting rights. In particular, state the existence of any type of restriction that may inhibit a takeover attempt of the company through acquisition of its shares on the market, and those regimes for the prior authorisation or notification that may be applicable, under sector regulations, to acquisitions or transfers of the company's financial instruments.**

Yes

#### Description of restrictions

In accordance with article 26 of the Company's Bylaws, no shareholder may exercise a number of votes exceeding 10 per cent of the total share capital with voting rights existing at any time, regardless of the number of shares held; all of the foregoing with full and mandatory submission to the provisions of the Law. In determining the maximum number of votes that each shareholder may cast, only the shares held by the shareholder in question shall be computed, not including those held by other holders who have delegated their representation to that shareholder, without prejudice to the application of the same percentage limit of 10% to each of the shareholders represented individually.

The limitation established in the preceding paragraph shall also apply to the maximum number of votes that may be cast - either jointly or separately - 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 legal entity that is a shareholder, and the entity or entities, also shareholders, that the former directly or indirectly controls.

For the purposes indicated in the previous paragraph, in order to consider the existence of a group of entities, as well as the control situations indicated above, the provisions of article 18 of the Corporations Act shall apply.

In addition, and in accordance with article 527 of the Corporations act, in listed companies, the bylaw's clauses that, directly or indirectly, establish, in general terms, the maximum number of votes that may be cast by a single shareholder, companies belonging to the same group or those acting in concert with the foregoing shall cease to have effect when, following a takeover bid, the offerer has reached a percentage equal to or greater than 70 per cent of the capital carrying voting rights, unless the said offerer is not subject to equivalent neutralization measures or has not adopted them.

On the other hand, the provisions of Law 19/2003 of 4 July, on the Legal System of Transfers of Capital and of Financial Transactions with Foreign Countries and on Certain Measures for the Prevention of Money Laundering (Article 7), establishes that the Government may agree to the suspension of the regime of deregulation on

foreign investments set out in such with regard to acts, businesses, transactions or operations that, by their nature, form or conditions of performance, affect or may affect activities directly related to national defense, or activities that affect or may affect public order, public safety and public health.

**.13 State if the shareholders have resolved at a meeting to adopt measures to neutralise a take-over bid pursuant to the provisions of Act 6/2007.**

No

**If so, please explain the measures approved and the terms under which such limitations would cease to apply:**

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Explain the measures approved and the terms under which such limitations would cease o apply

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**A.14 State if the company has issued shares that are not traded on a regulated EU market.**

Yes

**If so, please list each type of share and the rights and obligations conferred on each.**

**List each type of share**

At the date of issue of this Report, 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 have all 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 State whether there are any differences between the quorum established by the LSC for General Shareholders' Meetings and those set by the company and if so, describe them in detail:**

No

**B.2 State whether there are any differences in the company's manner of adopting corporate resolutions and the manner for adopting corporate resolutions described by the LSC and, if so, explain:**

No

**Describe how it is different from that contained in the LSC.**

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**B.3 State the rules for amending the company's Articles of Association. In particular, state the majorities required for amendment of the Articles of Association and any provisions in place to protect shareholders' rights in the event of amendments to the Articles of Association.**

The Bylaws and Regulations for the General Shareholders Meeting of Telefónica confer upon the General Shareholders Meeting the power to agree the amendment of 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 established on 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 summoned 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 favor 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 justifying the amendment, which must be made available to shareholders when the General Meeting is called to deliberate on the 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 be amended, and note that all the Shareholders are entitled to analyze the full text of the proposed amendment and the report on such amendment at the registered offices, as well as to request such documents to be delivered or sent to them 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 Give details of attendance at General Shareholders' Meetings held during the year of this report and the previous year:**

Attendance data					
Date of general meeting	% physically present	% present by proxy	% distance voting		Total
			Electronic voting	Other	
12/05/2016	0.21%	55.34%	0.03%	0.55%	56.13%
Of which, free float	0.03%	32.91%	0.03%	0.55%	33,52%
09/06/2017	0.27%	55.71%	0.03%	0.49%	56.50%
Of which, free float	0.06%	35.87%	0.03%	0.49%	36.45%
08/06/2018	0.09%	52.80%	0.04%	0.49%	53.42%
Of which, free float	0.03%	34.64%	0.04%	0.49%	35.20%

**B.5 State whether any point on the agenda of the General Shareholders' Meetings during the year has not been approved by the shareholders for any reason.**

No

**B.6 State if the Articles of Association contain any restrictions requiring a minimum number of shares to attend General Shareholders' Meetings, or on distance voting:**

Yes

Number of shares requires to attend General Meetings	300
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Number of shares requires for distance voting	300
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**B.7 State whether it has been established that certain decisions other than those established by law exist that entail an acquisition, disposal or contribution to another company of essential assets or other similar corporate transactions that must be subject to the approval of the General Shareholders' Meeting.**

No

Explain the decisions that must be subject to the General Shareholders' Meeting, other than those established by law
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**B.8 State the address and manner of access to the page on the company website where one may find information on corporate governance and other information regarding General Shareholders' Meetings that must be made available to shareholders through the company website.**

Telefónica complies with applicable legislation and best practices in terms of the content of its website concerning Corporate Governance. In this respect, it fulfills both the technical requirements for access and content of the Company website, including information on General Shareholders Meetings, through direct access from the homepage of Telefónica, S.A. ([www.telefonica.com](http://www.telefonica.com)) in the section "Shareholders and Investors" ([www.telefonica.com/accionistaseinversores](http://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 Maximum and minimum number of directors established in the Articles of Association and the number set by the general meeting:

Maximum number of directors	20
Minimum number of directors	5

Number of directors set by the general meeting	17
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Remarks
The General Ordinary Shareholders' Meeting held on June 9, 2017, approved the establishment of seventeen members as the number of Board of Directors.

#### C.1.2 Please complete the following table on directors:

Name of director	Natural person representative	Director category	Position on the Board	Date first appointed to Board	Last re-election date	Method of selection to Board
Mr. José María Álvarez-Pallete López	—	Executive	Chairman	26/07/2006	09/06/2017	Resolution of General Shareholders' Meeting
Mr. Isidro Fainé Casas	—	Proprietary	Vice Chairman	26/01/1994	12/05/2016	Resolution of General Shareholders' Meeting
Mr. José María Abril Pérez	—	Proprietary	Vice Chairman	25/07/2007	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Ángel Vilá Boix	—	Executive	Chief Operating Officer (C.O.O.)	26/07/2017	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Juan Ignacio Cirac Sasturain	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. José Javier Echenique Landiribar	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. Peter Erskine	—	Other External	Director	25/01/2006	12/05/2016	Resolution of General Shareholders' Meeting
Ms. Sabina Fluxà Thienemann	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. Luiz Fernando Furlán	—	Independent	Director	23/01/2008	08/06/2018	Resolution of General Shareholders' Meeting
Ms. Carmen García de Andrés	—	Independent	Director	04/05/2017	09/06/2017	Resolution of General Shareholders' Meeting

Ms. María Luisa García Blanco	—	Independent	Director	25/04/2018	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Jordi Gual Solé	—	Proprietary	Director	31/01/2018	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Peter Löscher	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. Ignacio Moreno Martínez	—	Proprietary	Director	14/12/2011	09/06/2017	Resolution of General Shareholders' Meeting
Mr. Francisco Javier de Paz Mancho	—	Independent	Director	19/12/2007	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Francisco José Riberas Mera	—	Independent	Director	04/05/2017	09/06/2017	Resolution of General Shareholders' Meeting
Mr. Wang Xiaochu	—	Proprietary	Director	30/09/2015	12/05/2016	Resolution of General Shareholders' Meeting

Total number of directors

17

**State if any directors, whether through resignation, dismissal or any other reason, have left the Board during the period subject to this report:**

Name of director	Director type at time of leaving	Date of last appointment	Date director left	Specialised committees of which he/she was member	Indicate whether the director left before the end of the term
Ms. Eva Castillo Sanz	Other external Director	31/05/2013	25/04/2018	Regulation and Institutional Affairs Committee (Member) Service Quality and Consumer Service Committee (Member) Strategy and Innovation Committee (Member)	Yes

**Reason for leaving and other remarks**

The Director Ms. Eva Castillo Sanz, in order to facilitate the renewal of the Board of Directors, formally and expressly stated her voluntary resignation to the Board of Directors, at its meeting held on April 25, 2018, effective as of that date, from its position as Director of Telefónica, S.A., and thus from all of her position within the Board of Directors and within the Committees of such Board (member of the Service Quality and Customer Service Committee, of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee).

**C.1.3 Complete the following tables regarding the members of the Board and their categories:**

**EXECUTIVE DIRECTORS**

Name or company name of director	Post in organisational chart of the company	Profile
Mr. José María Álvarez-Pallete López	Executive Chairman	Degree in Economics. International Management Program (IPM) from IPADE Business School (Instituto Panamericano de Alta Dirección de Empresa). An Advance Research Degree from the Department of Financial Economics and Accounting.
Mr. Ángel Vilá Boix	Chief Operating Officer (C.O.O.)	Degree in Industrial Engineering. MBA at Columbia Business School.

<b>Total number of executive directors</b>	2
<b>Percentage of Board</b>	11.76%



## PROPRIETARY DIRECTORS

Name of Director	Name or company name of the significant shareholder represented or that has proposed their appointment	Profile
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Degree in Economics. Professor at the University of Deusto.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Degree in Economics and Business Administration. MBA at INSEAD. Chairman of Metrovacesa, S.A. and Director of Roadis Transportation Holding, S.L.U. Senior Advisor of BC Partners for Spain.
Mr. Isidro Fainé Casas	CaixaBank, S.A.	PhD in Economics. ISMP in Business Administration. Post graduate degree in senior management at IESE. An academic at the Royal Academy of Economic and Financial Sciences and at the Real Academia de Doctores. Chairman of the Board of Trustees of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona "la Caixa" and Criteria Caixa, S.A.U. Honorary Chairman of Naturgy Energy Group, S.A. Chairmanship of the Spanish Confederation of Savings Banks (CECA), and Chairman of the Spanish Confederation of Directors and Executives (CEDE).
Mr. Jordi Gual Solé	CaixaBank, S.A.	PhD in Economics. Professor of Economics at the IESE Business School. Research Fellow at the Centre for Economic Policy Research (CEPR) in London. Chairman of CaixaBank, S.A. Chairman of <i>Fundación de Estudios de Economía Aplicada</i> (FEDEA).
Mr. Wang Xiaochu	China Unicom (Hong Kong) Limited	Degree in Telecommunications Engineering. Doctorate degree in Business Administration. Professor level senior engineer. Chairman of China United Network Communications Group Company Limited ("Unicom Group"), China United Network Communications Limited and China United Network Communications Corporation Limited, and as an Chairman and Chief Executive Officer of China Unicom (Hong Kong) Limited.

Number of independent directors	5
Percentage of the Board	29.41%

## INDEPENDENT DIRECTORS

Name of director	Profile
Mr. Juan Ignacio Cirac Sasturain	Graduated in Theoretical Physics. PhD in Physics. Fields of specialization in Quantum Optics, Quantum Computation, Atomic Physics.
Mr. José Javier Echenique Landiribar	Economics and Actuarial Sciences Graduate. Professor of Social Security Quantitative Techniques. ViceChairman of Banco Sabadell, S.A. Director of ACS Actividades de Construcción y Servicios, S.A., of ACS Servicios, Comunicaciones y Energía, S.L., and Grupo Empresarial ENCE, S.A.
Ms. Sabina Fluxà Thienemann	Degree in Business Management and Administration. MBA from ESADE. High Business Management Program at IESE. ViceChairman and CEO of Iberostar Group.
Mr. Luiz Fernando Furlán	Degree 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.
Ms. Carmen García de Andrés	Degree in Economic and Business Sciences. Chairwoman of Tomillo Foundation.
Ms. María Luisa García Blanco.	Degree in Law. State Attorney (on leave of absence). Founding Partner at law firm Salama García Blanco.
Mr. Peter Löscher	Degree in Economics and Business. MBA at Vienna University of Economics. Advanced Management Program at Harvard Business School. Chairman of the Supervision Board of OMV Aktiengesellschaft and Sulzer AG.
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. Francisco José Riberas Mera	Degree in Law and in Economics and Business Administration. Chief Executive Officer of Gestamp Automoción, S.A.

Total number of independent directors	9
Percentage of the Board	52.94%

State whether any independent director receives from the company or any company in the group any amount or benefit other than compensation as a director, or has or has had a business relationship with the company or any company in the group during the past year, whether in his or her own name or as a significant shareholder, director or senior executive of a company that has or has had such a relationship.

No

In this case, include a statement by the Board explaining why it believes that the director in question can perform his or her duties as an independent director.

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#### OTHER EXTERNAL DIRECTORS

Identify the other external directors and state the reasons why these directors are considered neither proprietary nor independent, and detail their ties with the company or its management or shareholders:

Name of director	Reason	Company, director or shareholder to whom the director is related	Profile
Mr. Peter Erskine	Mr. Peter Erskine was appointed Director of Telefónica, S.A. in 2006, and therefore, in accordance with article 529 duodecies of the Spanish Companies Act ("Those who, among other situations, have been Directors for a continuous period of more than 12 years may not be considered Independent Directors under any circumstances"), and 12 years after his appointment, he was reclassified from Independent Director to "Other External" Director.	Telefónica, S.A.	Degree in Psychology. Until December 2007 he was General Manager of Telefónica Europe. Until December 2015 he was Chairman of Ladbrokes, Plc.

Total number of other external directors	1
Percentage of the Board	5.88%

State any changes in status that has occurred during the period for each director:

Name of director	Date of change	Previous Status	Current Status
Mr. Peter Erskine	25/01/2018	Independent Director	Other External Director

C.1.4 Complete the following table with information relating to the number of female directors at the close of the past 4 years, as well as the category of each:

	Number of female directors				% of directors for each category			
	Year 2018	Year 2017	Year 2016	Year 2015	Year 2018	Year 2017	Year 2016	Year 2015
<b>Executive</b>	0	0	0	0	0.00%	0,00%	0,00%	0,00%
<b>Proprietary</b>	0	0	0	0	0.00%	0,00%	0,00%	0,00%
<b>Independent</b>	3	2	1	0	33.33%	22.22%	11.11%	0,00%
<b>Other external</b>	0	1	1	1	0.00%	100.00%	33.33%	33.33%
<b>Total</b>	3	3	2	1	17.65%	18.75%	11.11%	5.56%

#### Remarks

The number of female Directors in the financial year 2017 and 2018 was the same (3 female Directors). However, the percentage of female Directors over the total number of Board members is different in one year and in another, since at December 31, 2017 the number of Directors was 16, and at December 31, 2018 it was 17.

**C.1.5 State whether the company has diversity policies in relation to the Board of Directors of the company on such questions as age, gender, disability and training and professional experience. Small and medium-sized enterprises, in accordance with the definition set out in the Accounts Audit Act, will have to report at least the policy they have implemented in relation to gender diversity.**

Yes

**Should this be the case, describe these diversity policies, their objectives, the measures and way in which they have been applied and their results over the year. Also state the specific measures adopted by the Board of Directors and the appointments and remuneration committee to achieve a balanced and diverse presence of directors.**

**In the event that the company does not apply a diversity policy, explain the reasons why.**

**Description of policies, objectives, measures and how they have been implemented, including results achieved**

Telefónica S.A. has a Board Member Selection Policy as of November 25, 2015. This Policy was updated on December 13, 2017 to include the Diversity Policy applicable to the Board of Directors and, as a consequence, was renamed the Diversity Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members. This Policy is concrete and verifiable, and as of November 25, 2015 (before its update of December 13, 2017), assures that the proposals for appointments or re-election of Board Members is based on a prior analysis of the Board of Director's needs, and favor a diversity of knowledge, training and professional experience, age and gender, ensuring that such proposals are free from any implicit bias entailing any kind of discrimination, particularly by reason of gender, disability or any other personal condition.

In accordance with the aforementioned Policy, the selection of candidates for Director of Telefónica shall adhere to the following principles:

1. Efforts will be made for the Board of Directors to have a balanced composition, with a large majority of non-Executive Directors and an appropriate mix of Proprietary and Independent Directors.
2. The Board of Directors shall endeavor to ensure that the Director selection procedures favor diversity of knowledge, training, professional experience, age and gender, and are free from any implicit bias entailing any kind of discrimination. All of the foregoing is in order for the Board of Directors to have a diverse and balanced

composition overall, which i) enriches analysis and debate, ii) contributes to multiple viewpoints and positions, iii) favors decision-making, and iv) gives it maximum independence.

It shall also ensure that the candidates for non-Executive Director have sufficient available time to properly perform their duties.

3. The process for selecting candidates for Director shall also be based on a prior analysis of the needs of the Company and of its Group. Such analysis must be performed by the Company's Board of Directors, with the advice and with the required prior justifying report of the Nominating, Compensation and Corporate Governance Committee.

4. Such report of the Nominating, Compensation and Corporate Governance Committee shall be published upon occasion of the call to the General Shareholders' Meeting at which the ratification, appointment or re-election of each Director is submitted.

5. The Nominating, Compensation and Corporate Governance Committee shall verify compliance with the Diversity Policy in relation to the Board of Directors of Telefónica, S.A. and the Selection of Directors on an annual basis, and information thereon shall be included in the Annual Corporate Governance Report and in such other documents as are deemed appropriate.

On the other hand, 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 for the position of Director are persons of recognized caliber, qualifications, training and professional experience, who are willing to devote a sufficient portion of their time and the required effort to the performance of their duties, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

In this regard, candidates for Director shall be persons of recognized prestige, caliber, training and professional experience, especially in the telecommunications, economic/financial, accounting, auditing, risk management and/or business management fields, with the ability to lead teams made up of persons belonging to various fields of activity, and extensive knowledge about large companies.

Likewise, it should be noted that the same criteria and principles that the Company applies in the process of selection and appointment of the members of the Board of Directors are also applied to the appointment of the Directors that are part of the different Committees of the Board of Directors of the Company.

Finally, and with regard to the performance evaluation, the Board of Directors must undertake an annual evaluation of its operations and that of its Committees, particularly evaluating the application of the various aspects of diversity contained in this Policy in the composition and powers of the Board of Directors, as well as the performance of the Chairman of the Board of Directors, of the Company's Chief Executive Officer, and of the various Directors, paying special attention to the heads of the various Committees of the Board, and shall adopt appropriate measures for the improvement thereof.

The Diversity Policy in relation to the Telefónica, S.A. Board of Directors and the Selection of Board Members is public and may be viewed on the corporate web page ([www.telefonica.com](http://www.telefonica.com)).

The Reports of the Board of Directors and the Nominating, Compensation and Corporate Governance Committee, drafted in relation to the proposals for re-election and ratification of appointments of Directors submitted to the General Shareholders' Meeting held on June 8, 2018, explain in detail how the Diversity Policy was applied in relation to the Board of Directors of Telefónica, S.A. and the Selection of Directors, as well as the diversity criteria applied in the selection process.

**C.1.6 Describe the means, if any, agreed upon by the appointments committee to ensure that selection procedures do not contain hidden biases which impede the selection of female directors and that the company deliberately seeks and includes women who meet the target professional profile among potential candidates and which makes it possible to achieve a balance between men and women:**

**Explanation of means:**

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 caliber, 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.

In this context, and as mentioned above, the Nominating, Compensation and Corporate Governance Committee analyzed and favorably reported the update of the Board Member Selection Policy (approved, in its first version, on November 25, 2015), which included the Diversity Policy applicable to the Telefónica, S.A. Board of Directors. It was thus renamed the Diversity Policy related to the Telefónica, S.A. Board of Directors and Board Member Selection, approved by the Board of Directors at their meeting held on December 13, 2017.

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.

**In the event there are few or no female directors in spite of any measures adopted, please explain the reasons that justify such situation:****Explanation of reasons:**

As shown in Table C.1.4, the selection procedures do not suffer from implicit biases that hinder the selection of Directors and in fact the Company has deliberately sought women who meet the professional profile sought. In this sense, regarding the percentage that female Directors represent with respect to the total number of members of the Board of Directors, in Table C.1.4, shows the qualitative leap that the Company has made in this area, having gone from 5.56% in 2015, to 17.65% in 2018.

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.

Thus, in the amendment carried out during the year 2016 in the composition of the Company's Board of Directors, Ms. Sabina Fluxà Thienemann was appointed unanimously by the Board of Directors, at the proposal of the Nominating, Compensation and Corporate Governance Committee, as Independent Director of Telefónica. This appointment was ratified by the Telefónica General Shareholder's Meeting held on May 12, 2016.

Likewise, in the amendment brought into effect in 2017 on the composition of the Board of Directors of the Company, the Board of Directors unanimously appointed Ms. Carmen García de Andrés as Independent Board Member of Telefónica, at the proposal of the Nominating, Compensation and Corporate Governance Committee. This appointment was ratified by the Telefónica General Shareholder's Meeting held on June 9, 2017.

Furthermore, in 2018, the Company's Board of Directors unanimously appointed Ms. María Luisa García Blanco as Independent Board Member of Telefónica, at the proposal of the Nominating, Compensation and Corporate Governance Committee. This appointment was ratified by the Telefónica General Shareholder's Meeting held on June 8, 2018.

In all the above mentioned proposals to appoint (Ms. Sabina Fluxà Thienemann, Ms. Carmen García de Andrés and Ms. María Luisa García Blanco), the Nominating, Compensation and Corporate Governance Committee considered the solvency, competency, experience, professional merits and availability of Ms. Fluxà, Ms. García de Andrés and Ms. García Blanco for their effective performance of the duties, exclusively considering their individual and professional characteristics. All of this was included in the framework of the Board Member Selection Policy, which, with respect to the promotion of the presence of Board Members in the Board of

Directors, already expressly imposed the obligation to favor gender diversity in Board Member selection procedures, and prohibited any type of implicit bias that could entail any discrimination.

**C.1.7 Describe the conclusions of the appointments committee regarding verification of compliance with the selection policy for directors; in particular, as it relates to the goal of ensuring that the number of female directors represents at least 30% of the total membership of the Board of Directors by the year 2020.**

**Explanation of the conclusions:**

Telefónica S.A. has a Board Member Selection Policy as of November 25, 2015. This Policy was updated on December 13, 2017 to include the Diversity Policy applicable to the Board of Directors and, as a consequence, was renamed the Diversity Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members. This Policy is concrete and verifiable, and as of November 25, 2015 (before its update of December 13, 2017), assures that the proposals for appointments or re-election of Board Members is based on a prior analysis of the Board of Director's needs, and favor a diversity of knowledge, training and professional experience, age and gender, ensuring that such proposals are free from any implicit bias entailing any kind of discrimination, particularly by reason of gender, disability or any other personal condition.

Within the framework of the Selection of Board Members Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members, during the 2018 fiscal year, the Nominating, Compensation and Corporate Governance Committee proposed and/or informed, as the case may be, the appointment of Telefónica S.A. Board Members in accordance to the aforementioned criteria, considering the solvency, competency, experience, professional merits, and disposition of the candidates to dedicate the time and effort necessary for the efficient performance of their duties, exclusively considering their personal and professional characteristics, all of this to favor a diversity of knowledge, training and professional experience, age and gender, ensuring that such proposals are free from any implicit bias entailing any kind of discrimination, particularly by reason of gender, disability or any other personal condition.

Thus, in its meeting celebrated on January 30, 2018 the Committee favorably informed the appointment by co-optation as Proprietary Director, and at the proposal of CaixaBank, S.A., of Mr. Jordi Gual Solé, after the voluntary resignation from its position as Board Member presented by Mr. Antonio Massanell Lavilla. Likewise, in its meeting celebrated on April 24, 2018, the Committee proposed to the Company's Board of Directors the appointment by co-optation as Independent Board Member of Ms. María Luisa García Blanco, replacing Ms. Eva Castillo Sanz. These appointments were ratified by the Ordinary General Shareholders' Meeting of Telefónica held on June 8, 2018, as explained below.

Likewise, within the framework of the Selection of Board Members Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members, the Committee favorably informed and/or proposed, as the case may be, the re-election and ratification of the Telefónica S.A. Board Members by the Company's Ordinary General Shareholders Meeting, considering and assessing the duties performed and the dedication of the Board Members, basing all of the proposals on a prior analysis of the Board of Director's needs, and favouring the diversity of knowledge, experiences, and gender.

Thus, the Ordinary General Shareholders' Meeting held on June 8, 2018 approved, at the proposal of the Company's Board of Directors, the re-election of Mr. Luiz Fernando Furlán, Mr. Francisco Javier de Paz Mancho, and Mr. José María Abril Pérez, as well as the ratification of the appointment by co-optation of Mr. Ángel Vilá Boix, Mr. Jordi Gual Solé, and Ms. María Luisa García Blanco.

In this sense, it must be noted that the Nominating, Compensation and Corporate Governance Committee verified the compliance of the Selection of Board Members Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members, on the occasion of the preparation of the proposals for appointment, re-election, and/or ratification of the Board Members submitted to the General Shareholders' Meeting held on June 8, 2018.

As for the percentage that the female Board Members represent with respect to the total number of members of the Board of Directors, a qualitative leap that the Company has taken in this field can be observed in figure C.1.4, passing from 5.56% in 2015 to 17.65% in 2018.

**C.1.8 If applicable, please explain the reasons for the appointment of any proprietary directors at the request of shareholders with less than a 3% equity interest:**

Name of shareholder	Reason
China Unicom (Hong Kong) Limited	On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited (China Unicom), expanding on their existing strategic alliance, signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their Strategic Partnership 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 accordance with prevailing legislation and the Company's Bylaws. Mr. Wang Xiaochu, Chairman and Chief Executive Officer of China Unicom (Hong Kong Limited) is currently member of the Board of Directors of Telefónica, S.A.

**State whether the Board has failed to meet any formal requests for membership from shareholders whose equity interest is equal to or higher than that of others at whose request proprietary directors have been appointed. If this is the case, please explain why the aforementioned requests were not met:**

No

**C.1.9 State the powers delegates by the Board of Directors, as the case may be, to directors or Board committees:**

Name of director	Brief description
Mr. José María Álvarez-Pallete López - Executive Chairman (Chief Executive Officer)	The Chairman of the Company, as the Executive Chairman (Chief Executive Officer), has been expressly delegated to him all the powers and competences 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 for itself, and may not delegate. In addition to the aforementioned delegation of powers, the Chairman of the Company has been granted in certain (not general) powers to perform specific operations approved by the company.
Mr. Ángel Vilá Boix- Chief Operating Officer (C.O.O.)	The Chief Operating Officer (C.O.O.) 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 By-laws or according to the Regulations of the Board of Directors. In addition to the aforementioned delegation of powers, the C.O.O. of the Company has been granted in certain (not general) powers to perform specific operations approved by the company.
Executive Commission of the Board of Directors	The Executive Commission has been delegated all the faculties and powers of the Board of Directors, except those which cannot be delegated.



**C.1.10 Identify any members of the Board who are also directors or officers in other companies in the group of which the listed company is a member:**

Name of director	Name of group member	Position	Does the director have executive powers?
Mr. José Javier Echenique Landiribar	Telefónica Móviles Mexico, S.A de C.V.	Director	No
	Telefónica Audiovisual Digital, S.L.U	Director	No
Mr. Peter Erskine	Telefónica Deutschland Holding, AG	Member of Supervisory Board	No
Mr. Luiz Fernando Furlan	Telefónica Brasil, S.A.	Director	No
Mr. Francisco Javier de Paz Mancho	Telefónica Móviles Argentina, S.A	Director	No
	Telefónica Brasil, S.A	Director	No
	Telefónica Móviles México, S.A de C.V	Director	No
	Telefónica Ingeniería de Seguridad, S.A	Chairman	No

**C.1.11 List any legal-person directors of your company who are members of the Board of Directors of other companies listed on official securities markets other than group companies, and have communicated that status to the Company:**

Name of director	Name of listed company	Position
Mr. José Javier Echenique Landiribar	Banco Sabadell, S.A	Vice-Chairman
	ACS, Actividades de Construcción y Servicios, S.A	Director
	Ence, Energía y Celulosa, S.A	Director
Mr. Isidro Fainé Casas	The Bank of East Asia	Director
	Suez Environment Company	Director
Mr. Luiz Fernando Furlán	Brasil Foods, S.A (BRF)	Director
Mr. Jordi Gual Solé	CaixaBank, S.A	Chairman
	Erste Group Bank, AG	Director
Mr. Peter Löscher	Sulzer AG	Chairman
	OMV Aktiengesellschaft	Chairman
Mr. Ignacio Moreno Martinez	Metrovacesa, S.A	Chairman
Mr. Francisco Riberas Mera	Gestamp Automoción, S.A	Chairman
	CIE Automotive, S.A	Director
	Global Dominion Access, S.A	Director
Mr. Wang Xiaochu	China United Networks Communications	Chairman
	China Unicom (Hong Kong) Limited	Chairman-Chief Operating Officer

### Remarks

Mr. Isidro Fainé Casas is Honorary Chairman of Naturgy Energy Group, S.A.

Mr. Jordi Gual Solé is member of the Supervisory Board of Erste Group Bank, AG.

Mr. Peter Löscher is Chairman of the Supervisory Board of OMV Aktiengesellschaft and Chairman of Sulzer AG.

#### C.1.12 State whether the company has established rules on the number of board on which its directors may hold sets, providing details if applicable, identifying, where appropriate, where his is regulated:

Yes

Explanation of the rules and identification of the document where this is regulated
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.1.13 State total remuneration received by the Board of Directors:

Board remuneration in financial year (thousand euros)	13,003
Amount of vested pension interests for current members (thousand euros)	15,900
Amount of vested pension interests for former members (thousand euros)	37,665

#### C.1.14 Identify senior management staff who are not executive directors and their total remuneration accrued during the year:

Name	Position
Mr. Pablo de Carvajal González	General Secretary, Secretary of the Board of Directors and Director Global of Regulation
Ms. Laura Abasolo García de Baquedano	Chief Finance and Control Officer
Mr. Guillermo Ansaldo Lutz	Chief Global Resources Officer
Mr. Mariano de Beer	Chief Commercial Digital Officer
Mr. Juan Francisco Gallego Arrechea	General Manager of Internal Audit

Total senior management remuneration (thousand euros)	9,045
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## Remarks

For these purposes, Senior Management is understood to be those persons who perform, de jure or de facto, senior management functions under the direct dependence of the Board of Directors, Executive Committees or Chief Executive Officers of the Company. In addition, the head of Internal Audit is included for the purposes of annual remuneration.

On January 31, 2018, Mr Pablo de Carvajal González, currently General Secretary, Secretary of the Board of Directors and Director Global of Regulation, was appointed in place of Mr Ramiro Sánchez de Lerín García-Ovies.

It is stated that the amount indicated above includes the remuneration perceived by Mr Ramiro Sánchez de Lerín García-Ovies, former Secretary-General and Secretary of the Board of Directors of Telefónica, S.A., until the date of his disengagement from Telefónica, S.A., including the compensation perceived as a result of his removal.

With effects as of January 2019, Mr Eduardo Navarro de Carvalho was appointed Chief Comms, Corporate Affairs, Brand and Sustainability Officer of the Telefónica Group, coming to form part of the Senior Management of the company. It is stated that the amount indicated above does not include their remuneration as a member of the Senior Management, which has accrued after the end of the 2018 fiscal year.

### **C.1.15 State whether the Board rules were amended during the year**

No

### **C.1.16 Specify the procedures for selection, appointment, re-election and removal of directors: the competent bodies, steps to follow and criteria applied in each procedure.**

See heading H "Other information of Interest". Note 3 to section C.1.16.

### **C.1.17 Explain how the annual evaluation of the Board has given rise to significant changes in its internal organisation and to procedures applicable to its activities:**

#### **Description of changes**

With respect to the Board of Directors assessment corresponding to 2017, the Company Board of Directors, based on the favorable report of the Nominating, Compensation and Corporate Governance Committee, agreed to entrust this evaluation to an external consultant, Villafañe & Asociados Consultores.

The aim of this work has been to help the Telefónica, S.A. Board of Directors make their corporate governance assessment by identifying measures for improvement in the governance with possible action plans, under the terms established in the Good Governance Code of the listed companies, approved by the Spanish National Securities Market Commission.

The assessment has been carried out from the review of the Company's Annual Reports corresponding to the 2016 fiscal year, and the Company's corporate documentation, as well as interviews to Independent Board Members, and to the Secretary of the Board of Directors and the Deputy Secretary of the Board of Directors.

The results obtained in this external assessment were satisfactory, standing out some very positive aspects of the corporate governance system of the Company.

Likewise, some recommendations were reflected in this evaluation to optimize the corporate governance system of the Company, related, among others, to:

- The operation of the Board of Directors, recommending the establishment of measures in order to have the documentation related to the issues to be discussed at Board and Committee meetings as far in advance as possible.

- The organization and the operation of the General Shareholder's Meeting, proposing to analyze the possibility of implementing opportune measures for its retransmission, provided that the circumstances thus permit this.
- The composition of the Board of Directors, proposing to continue advancing towards a percentage of 30% of female Board Members in its breakdown by 2020, as well as to continue to reduce the total number of Board Members.

On the other hand, and with respect to the Board of Directors assessment corresponding to 2018, in a meeting on February 19, 2019, the Nominating, Compensation and Corporate Governance Committee revised and analysed the results of the Directors of Telefónica, S.A.'s evaluation 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 assessment, 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, approved the suggested improvements described hereon in order to optimize the operation of the Company's governing bodies:

- i) Continue with the implementation of measures and actions that allow for an optimum performance of the General Shareholder's Meeting.
- ii) Continue with the process of analyzing the composition of the Board with regard to the implantation of succession plans and with the application of the Diversity Policy.
- iii) Evaluate to include more presentations on the agenda of the Board of Directors and of the Executive Commission related to the strategy, so that they can be subject to debate by the Board Members.

**Describe the evaluation process and the areas evaluated by the Board of Directors with the help, if any, of external advisors, regarding the function and composition of the board and its committees and any other area or aspect that has been evaluated.**

As indicated above, on an annual basis, all the Company's Directors assess the functioning of the Board of Directors of Telefónica, S.A., its Committees and of the General Shareholders' Meeting.

Subsequently, the Nominating, Compensation and Corporate Governance Committee reviews and analyzes the results of the assessment carried out by the Directors, identifying those areas that could be improved. After a detailed examination and analysis of the results achieved, the Nominating, Compensation and Corporate Governance Committee proposes to the Board of Directors the implementation of the suggestions and recommendations deemed appropriate.

With respect to fiscal year 2018, at the meeting of the Board of Directors held on December 12, all the Directors were given a questionnaire in order to carry out the assessment corresponding to said fiscal year.

The aforementioned questionnaire contained very diverse questions grouped into the following five sections:

- Composition, functioning and powers of the Board of Directors, expressly including the adequacy of the performance and contribution of the Directors to the Board of Directors.
- Composition and functioning of the Committees, expressly including the performance and contribution of the Chairmen of the Committees of the Board of Directors.
- Performance of the Executive Chairman.
- Rights and Duties of Directors.
- General Shareholders' Meeting.

– Other

As already indicated, once the questionnaires had been received, filled in with the opinions and suggestions of all the Directors, action plans were established on those matters that were identified as susceptible to improvement.

The Board of Directors unanimously approved the proposals for improvement formulated by the Nominating, Compensation and Corporate Governance Committee, in order to optimize the operation of the Company's Governing Bodies.

It should be noted that, in accordance with the Diversity Policy in relation to the Board of Directors of Telefónica, S.A. and the Board of Directors' Selection Policy, at least, every three years the Board of Directors will be assisted in carrying out the assessment by an external consultant, whose independence will be verified by the Nominating, Compensation and Corporate Governance Committee. Thus, the assessment corresponding to fiscal year 2017 was carried out by the External Consultant, Villafañe & Asociados Consultores.

**C.1.18 Describe, in those years in which the external advisor has participated, the business relationships that the external advisor or any group company maintains with the company or any company in its group.**

The assessment of the Board of Directors for fiscal year 2017 was carried out by the External Consultant, Villafañe & Asociados Consultores. Such External Consultant maintained in the referred fiscal year business relationship for a total amount of 119,003.5 euros for the execution of other work to Telefónica Group Companies.

In his regard, the assessment of the Board of Directors corresponding to fiscal year 2018 has been carried out internally by the Company, without having been assisted by an External Consultant.

**C.1.19 State the situation in which directors are required to 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 formalize 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 fulfill 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.1.16 ("Removal") above must also be taken into consideration.

**C.1.20 Are qualified majorities other than those established by law required for any specific decision?**

No

**If applicable, describe the differences.**

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**C.1.21 Explain whether there are any specific requirements, other than those relating to directors, to be appointed as chairman of the Board of Directors.**

Yes

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**Description of requirements**


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In accordance with Article 31.4 of the Corporate Bylaws, in order for a Director to be appointed Chairman, such 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 favorable vote of at least 85 percent of the members of the Board of Directors.

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**C.1.22 State whether the Articles of Association or the Board Rules establish any limit as to the age of directors:**

No

**C.1.23 State whether the Articles of Association or the Board Rules establish any term limits for independent directors other than those required by law:**

No

**C.1.24 State whether the Articles of Association or Board Rules establish specific proxy rules for votes at Board meetings, how they are to be delegated and, in particular, the maximum number of delegations that a director may have, as well as if any limit regarding the category of director to whom votes may be delegated and whether a director is required to delegate to a director of the same category. If so, please briefly describe the rules.**

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 endeavor 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 endeavor, to the extent possible, to include voting instructions in the proxy document.

**C.1.25 State the number of meetings held by the Board of Directors during the year, and if applicable, the number of times the Board met without the chairman present. Meetings where the chairman sent specific proxy instructions are to be counted as attended.**

Number of Board meetings	12
Number of Board meetings without the chairman	0

**State the number of meetings held by the coordinating director with the other directors, where there was neither attendance nor representation of any executive director:**

Number of meetings	0
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**Please specify the number of meetings held by each committee of the Board during the year:**

Number of meetings held by the Executive Committee	18
Number of meetings held by the Audit and Control Committee	13
Number of meetings held by the Nominating, Compensation and Corporate Governance Committee	11
Number of meetings held by the Service Quality and Customer Services Committee	4
Number of meetings held by the Regulation and Institutional Affairs Committee	11
Number of meetings held by the Strategy and Innovation Committee	10

**C.1.26 State the number of meetings held by the Board of Directors during the year in which all of its directors were present. For the purposes of this section, proxies given with specific instructions should be considered as attendance:**

Number of meetings attended in person by at least 80% of the directors	10
% of personal attendance over the total of votes cast during the fiscal year	89.22%
Number of meetings attended in person, or representations made with specific instructions, of all directors	12%
% of votes personally cast and representations realized with specific instructions over the total of votes cast during the fiscal year.	100%

**C. 1.27 State if the individual and consolidated financial statements submitted to the Board for preparation were previously certified:**

No

#### Remarks

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.

**State if the individual and consolidated financial statements submitted to the Board for preparation were previously certified:**

-

**C.1.28 Explain any measures established by the Board of Directors to prevent the individual and consolidated financial statements prepared by the Board from being submitted to the General Shareholders' Meeting with a qualified audit opinion.**

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 materialize; 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 jeopardize the Auditor's independence, and, when applicable, the authorization 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 individualized 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. Analyze 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. Likewise, in accordance with the current regulation, the Committee has reviewed the non-financial and diversity information prepared by the Company.

On the other hand, different members of the Telefónica Group management group attend the Audit and Control Committee meetings, with supportive and assistance duties to the Committee members on the issues that are subject to be analyzed at each of the meetings. In particular, by invitation from the Chairman of the Committee, and when considered necessary, representatives of the General Secretary and the Board, Finance and Control, Internal Auditing, Intervention and Inspection, and Compliance attend the Committee meetings.

In addition to the aforementioned, and as a requirement of its own Committee, other managers from the Company and its subsidiary companies participate to present specific issues that affect their respective businesses or their assigned duties.

The meetings held with the Account Auditor and the Internal Auditor comply with that established in article 7 of the regulations of the Audit and Control Committee of the Company, which establishes that, for the appropriate performance of their supervisory duty, the Committee must know and understand the decisions of Management regarding the application of the most significant criteria and results of the revisions made by Internal Auditing, staying in constant communication with the Account Auditor. In fact, the External Auditor has intervened in meetings of the Audit and Control Committee to explain the work done, as well as to clarify, at the Committee's request, any issues that may have arisen related to the functions assigned to said External Auditor.

The members of the Committee have held meetings separately with each of these interlocutors when it has been deemed necessary, in order to carry out a rigorous follow-up of 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.1.29 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:**

<b>Name of the secretary</b>	<b>Representative</b>
Mr. Pablo de Carvajal González	—

#### **Remarks**

On January 31, 2018, Mr Pablo de Carvajal González, currently General Secretary, Secretary of the Board of Directors and Director Global of Regulation, was appointed in place of Mr Ramiro Sánchez de Lerín García-Ovies.

**C.1.30 State, if any, the concrete measures established by the entity to ensure the independence of its external auditors, financial analysts, investment banks, and rating agencies, including how legal provisions have been implemented in practice.**

With regards to the independence of the External Auditor of the Company, and in accordance with the Regulations of the Board of Directors of Telefónica (Article 40), the Board has established, through the Audit and Control Committee, a stable and professional relationship with the Company's Auditor, strictly respecting the independence thereof.

Likewise, the Audit and Control Committee has a fundamental responsibility, as specified in Article 22 of the Regulations of the Board and in Article 4 of the Regulations of the Audit and Control, to 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 authorization 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 receives, 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 individualized 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 also issues 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 focuses 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.

Moreover, and in accordance with the Regulations of the Board of Directors (Article 22), 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 informs 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. Likewise, as established in Article 40 of the Regulations of the Board of Directors, every year the Auditor has 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 Spanish, European and 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 Spanish and European 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 remuneration 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.

In consequence the Company has implemented, in practice, the legal provisions in this matter according to what was referred in the previous paragraph.

**C.1.31 State whether the company changed its external auditor during the year. If so, please identify the incoming and outgoing auditor:**

No

**Remarks**

The Board of Directors of Telefónica, S.A. at its meeting held April 8, 2016, on a proposal from its Audit and Control Committee and as a result of a transparent competitive process, has resolved to propose to the next Ordinary General Shareholders Meeting the appointment of PricewaterhouseCoopers Auditores S.L. as statutory auditor for the Annual Accounts of Telefonica, S.A. and its Consolidated Group of Companies for the years 2017, 2018 and 2019. Such appointment was approved by the General Shareholders Meeting held on May 12, 2016.

**If there were any disagreements with the outgoing auditor, please provide an explanation:**

No

**C.1.32 State whether the audit firm provides any non-audit services to the company and/or its Group and, if so, the fees paid and the corresponding percentage of total fees invoiced to the company and/or Group:**

No

**C.1.33 State whether the auditors' report on the financial statements for the preceding year contains a qualified opinion or reservations. If so, please explain the reasons given by the chairman of the audit committee to explain the content and extent of the aforementioned qualified opinion or reservations.**

No

**C.1.34 State the number of consecutive years the current audit firm has been auditing the financial statements of the company and/or group. Furthermore, state the number of years audited by the current audit firm as a percentage of the total number of years that the financial statements have been audited:**

	Individual	Consolidated
Number of consecutive years	2	2
Number of years audited by the current audit firm/ number of fiscal years the company has been audited (by %)	5.60	7.10

**Remarks**

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.

**C.1.35 State whether there is a procedure whereby directors have the information necessary to prepare the meetings of the governing bodies with sufficient time and provide details if applicable:**

Yes

**Explanation of procedure**

The Company adopts the necessary measures, whenever possible, 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, and in accordance with Articles 18 and 20 of the Regulation of the Board of Directors, 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. Likewise, the Regulations of the Audit and Control Committee detail the operating regime of this Committee.

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, in general, the Directors are sent the documentation related to the agenda of the meetings sufficiently in advance. In accordance with Article 19 of the Regulations of the Board of Directors, the Chairman of the Board of Directors organizes 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 (Article 26) 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 channeled 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 organization.

**C.1.36 State whether the company has established rules whereby directors must provide information regarding and, if applicable, resign, in circumstances that may damage the company's standing and reputation. If so, provide details:**

Yes

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**Explain the rules**

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In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation when their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardizes 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.

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**C.1.37 State whether any member of the Board of Directors has notified the company that he or she has been tried or notified that legal proceedings have been filed against him or her, for any offenses described in Article 213 of the LSC:**

No

**C.1.38 Detail any material agreements entered into by the company that come into force, are modified or are terminated in the event of a change in control of the company following a public 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. - Financing agreements:

On March 15, 2018, Telefónica, S.A., as borrower, and a group of credit entities, as original lenders, with National Westminster Bank plc as the agent bank, entered into a syndicated loan amounting up to EUR 5,500 million.

On December 11, 2015, Telefónica, S.A., as borrower, and Banco Bilbao Vizcaya Argentaria, S.A. Niederlassung Deutschland, the Bank of Tokyo-Mitsubishi UFJ, Ltd., sucursal in Spain, Mizuho Bank Ltd, AB Svensk Exportkredit and Société Générale S.A., as original lenders, and with the support of Exportkreditnämnden, signed a financing agreement amounting up to USD 750 million. Also on that same date, Telefónica, S.A., as borrower, and Banco Santander, S.A. and Crédit Agricole Corporate and Investment Bank as original lenders, with the support of Finnvera Plc, entered into a financing agreement amounting up to EUR 500 million.

As provided for in all of the aforementioned contracts, in the event of a change of control in Telefónica, S.A., lenders may, under certain circumstances, require the early termination of these financing agreements.

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 the majority of members of the board of directors, or on the Company's financial and operational policies.

**C.1.39 Identify individually for director, and generally in other cases, and provide detail of any agreements made between the company and its directors, executives or employees containing indemnity or golden parachute clauses in the event of resignation or dismissal or termination of employment without cause following a takeover bid or any other type of transaction.**

<b>Number of beneficiaries</b>	27
<b>Type of beneficiaries</b> Executive Directors, Senior Managers and other Employees	
<p>With regards to the conditions applicable to termination of contracts, the Executive Chairman, Mr. José María Álvarez-Pallete López, and the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, maintain the conditions of his previous contract which provided for agreed economic compensation for the termination of the employment relationship, where applicable, that can amount to four years' of remuneration at the most. 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.</p> <p>Regarding the contracts of members of Senior Management, in general, they are contractually entitled 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.</p> <p>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 labor 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 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 b contract.</p>	

State if these contracts have been communicated to and/or approved by management bodies of the company or of the Group. If they have, specify the procedures, events and nature of the bodies responsible for their approval or for communicating this:

	<b>Board of directors</b>	<b>General Shareholders' Meeting</b>
<b>Body authorizing the severance clauses</b>	No	No
<b>Are these clauses notified to the General Shareholders' Meeting</b>	No	

## C.2 Committees of the Board of Directors

**C.2.1 Provide details of all committees of the Board of Directors, their membership, and the proportion of executive, proprietary, independent and other external directors that comprise them:**

### AUDIT AND CONTROL COMMITTEE

Name	Post	Category
Mr. José Javier Echenique Landiríbar	Chairman	Independent
Ms. Carmen García de Andrés	Member	Independent
Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of executive directors	0.00%
% of proprietary directors	25.00%
% of independent directors	75.00%
% of other external directors	0.00%

**Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.**

See heading H "Other information of interest. Note 4 to section C.2.1.

**Identify the directors who are member of the audit committee and have been appointed taking into account their knowledge and experience in accounting or audit matters, or both, and state the date that the Chairperson of this committee was appointed.**

<b>Name of directors with experience</b>
Mr. José Javier Echenique Landiríbar
<b>Date of appointment of the chairperson</b>
08/04/2016

### SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Post	Category
Mr. Peter Löscher	Chairman	Independent
Ms. Carmen García Andrés	Member	Independent
Ms. María Luisa García Blanco	Member	Independent
Mr. Ignacio Moreno Martínez	Member	Proprietary

% of executive directors	0.00%
% of proprietary directors	25.00%
% of independent directors	75.00%
% of other external directors	0.00%

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organisation and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H “Other information of interest”. Note 5 to section C.2.1.

#### STRATEGY AND INNOVATION COMMITTEE

Name	Post	Category
D. Peter Erskine	Chairman	Other external
D. José María Abril Pérez	Member	Proprietary
D. Juan Ignacio Cirac Sasturain	Member	Independent
Mr. Jordi Gual Solé	Member	Proprietary
D. Peter Löscher	Member	Independent

% of executive directors	0.00%
% of proprietary directors	40.00%
% of independent directors	40.00%
% of other external directors	20.00%

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H “Other information of interest”. Note 6 to section C.2.1.

#### NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Post	Category
Mr. Francisco Javier de Paz Mancho	Chairman	Independent
Mr. José Javier Echenique Landiribar	Member	Independent
Mr. Peter Erskine	Member	Other external
Ms. Sabina Fluxà Thienemann	Member	Independent
Mr. Luiz Fernando Furlán	Member	Independent

% of executive directors	0.00%
% of proprietary directors	0.00%
% of independent directors	80.00%
% of other external directors	20.00%

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H “Other information of interest”. Note 7 to section C.2.1.



## REGULATION AND INSTITUTIONAL AFFAIRS COMMITTEE

Name	Post	Category
Mr. Ignacio Moreno Martinez	Chairman	Proprietary
Ms. María Luisa Garcia Blanco	Member	Independent
Mr. Jordi Gual Solé	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of executive directors	0.00%
% of proprietary directors	50.00%
% of independent directors	50.00%
% of other external directors	0.00%

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H "Other information of interest". Note 8 to section C.2.1.

## EXECUTIVE COMMISSION

Name	Post	Category
Mr. José María Álvarez-Pallete López	Chairman	Executive
Mr. Isidro Fainé Casas	Vice Chairman	Proprietary
Mr. José María Abril Pérez	Vice Chairman	Proprietary
Mr. Ángel Vilá Boix	Member	Executive
Mr. José Javier Echenique Landiribar	Member	Independent
Mr. Peter Erskine	Member	Other External
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of executive directors	28.57%
% of proprietary directors	28.57%
% of independent directors	28.57%
% of external directors	14.29%

Explain the duties exercised by this committee, other than those that have already been described in Section C.1.10, and describe the rules and procedures it follows for its organisation and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

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 and exercise of its duties.

During the 2018 year, the Executive Commission of the Board of Directors of Telefónica, S.A. has analyzed and reviewed, and deliberated upon and adopted resolutions (which have been ratified by the Board of Directors of the Company), on a range of matters concerning, inter alia:

- The business activity performed by the Telefónica Group: i) products and services (E2E Digitalization, Internet of Things, Security B2B, Network, Terminals, Business Intelligence, Big Data, voice and data services, video, 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).
- Financing transactions of the Telefónica Group.

**C.2.2 Complete the following table with information regarding the number of female directors who were members of Board committees at the close of the past four years:**

	Number of female directors			
	2018 Year Number %	2017 Year Number %	2016 Year Number %	2015 Year Number %
Audit and Control Committee	1 (25.00%)	1 (25.00%)	0	0
Service Quality and Customer Service Committee	2 (50.00%)	2 (66.67%)	1 (20.00%)	1 (14.29%)
Strategy and Innovation Committee	0	1 (20.00%)	1 (14.29%)	0
Nominating, Compensation and Corporate Governance Committee	1 (20.00%)	1 (20.00%)	1 (20.00%)	0
Regulation and Institutional Affairs Committee	1 (25.00%)	1 (33.33%)	1 (16.67%)	0
Executive Commission	0	0	0	0

**C.2.3 State, where applicable, the existence of any regulations governing Board committees, where these regulations may be found, and any amendments made to them during the year. Also state whether any annual reports on the activities of each committee have been voluntarily prepared.**

The organization and operation of the Board of Directors Committees is governed under the regulations of the Board of Directors. Additionally and in particular, the Executive Commission is regulated under article 38 of the corporate bylaws; the Audit and Control Committee under article 39 of the corporate bylaws and the regulations of the Audit and Control Committee (approved by the Company Board of Directors at its meeting held on December 13, 2017, based on the recommendation of the Audit and Control Committee); and the Nominating, Compensation and Corporate Governance Committee under article 40 of the aforementioned bylaws. These documents are available for perusal on the Company website.

As mentioned in Section C.2.1 above, the Board Committees draw up an Activities Report (where, in the case of the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee, the Operating Report is named), summarizing 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.

Specifically, and with respect to the Nominating, Compensation and Corporate Governance Committee (in accordance with that established in Recommendation 6 of the Good Governance Code of the listed companies), and the Audit and Control Committee (in accordance with that established in Recommendation 6 of the Good Governance Code of the listed companies, in Section 79 of Technical Guide 3/2017 of the Spanish National Securities Market Commission regarding Audit Committees of Public Interest Companies, and in Article 9 of the regulations of the Audit and Control Committee of Telefónica, S.A.), an Operation Report is prepared annually. This report is published on the Company website well before the General Shareholder's Meeting is held.

## D. RELATED-PARTY AND INTRAGROUP TRANSACTIONS

### D.1. Describe, if applicable, the procedure for approval of related-party and intragroup transactions .

The 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 favorable 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, the 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 favorable 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 fulfill the three following requirements:

- 1.º they are performed by virtue of contracts whose conditions are standardized and are applied on an across-the-board basis to a large number of clients,
- 2.º they are performed at prices or tariffs generally set by the person supplying the goods or services, and
- 3.º 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 Describe any transactions which are significant, either because of the amount involved or subject matter, entered into between the company or entities within its group and the company's significant shareholders:

Name of significant shareholder	Name of company within the group	Nature of the relationship	Type of transaction	Amount (thousand euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	10,779
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	1,613
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Others	11,040
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: Loans	261,748
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees	322
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance Arrangements: others	595,459
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earning	123,650
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest paid	26,013
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease agreements	57
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	3,980
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest charged	41,948
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	25,702
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	2,561
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Others	645,675
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance Arrangements: Loans	44,430
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees	201,432
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	218
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	17
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Remunerations	3,580
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Collaboration agreements	405
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Interest paid	7,202
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Receipt of services	1,293
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: Loans	270,660
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Guarantees	8,231
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: Loans	890,958

CaixaBank, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	104,955
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Interest paid	1,774
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	4,625
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Services rendered	60,104
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	48,197
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	9,893
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Guarantees	96,192
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	93,685
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Other	300,010
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Purchase of goods (finished or in progress)	60,473

### Remarks

It is important to note that:

Transactions included in this section under 'Other', amounting to 11,040 with Banco Bilbao Vizcaya Argentaria, S.A. refer to Dividends received.

Transactions included in this section under 'Other', for the sum of 645,675 with Banco Bilbao Vizcaya Argentaria, S.A. refer to Other Revenues (2,794), to Other Expenses (75), to Gains from derecognition or disposal of assets (8), and to Outstanding factoring operations (642,798).

Transactions included in this section under 'Other', for the sum of 300,010 with CaixaBank, S.A., refer to Other Expenses (10) and to Outstanding factoring operations (300,000).

In addition, the nominal value of outstanding derivatives held with Banco Bilbao Vizcaya Argentaria, S.A. and CaixaBank, S.A. in 2018 amounted to 17,962 and 543 million euros, respectively. As explained under Derivatives policy in Note 17, 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 net fair value of these same derivatives in the statement of financial position is 428 and -10 million euros, respectively at December 31, 2018. Additionally, at December 31, 2018, collateral guarantees on derivatives from BBVA and la Caixa have been received, amounting to 8 and 6 million euros, respectively.

On the other hand, in July 2018, there was a non-extinguishing modifying novation of the investment and agreement between shareholders related to Telefónica Consumer Finance, E.F.C., S.A. signed between Telefónica, S.A., CaixaBank Consumer Finance, E.F.C., S.A. (formerly Finconsum, E.F.C., S.A.) and CaixaBank, S.A. on 6 September 2013, adhered to by Telefónica Consumer Finance, E.F.C., S.A. on 6 February 2014 (the "Novation of the Agreement of Investment and Contract between Shareholders"), in order to implement as an activity of Telefónica Consumer Finance, E.F.C., S.A. the granting of financing products from users from the universe of customers of the Telefónica Group in Spain, as well as for the corporate governance of Telefónica Consumer Finance, E.F.C., S.A. to adapt to the new regulatory framework applicable to the Financial Credit Institutions. |

Similarly, in September 2018, a statement of intent was signed between Telefónica Digital España, S.L.U. and Banco Bilbao Vizcaya Argentaria, S.A., in order to explore a potential partnership to offer financing to consumers, the self-employed and small companies in Argentina, Colombia, Peru and Mexico.

Likewise, in December 2018 a financial collaboration agreement was signed between Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A., with special conditions for employees, pensioners and early-retirees of the Telefónica Group.

**D.3 Describe any transactions that are significant, either because of their amount or subject matter, entered into between the company or entities within its group and directors or managers of the company:**

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**D.4 Report any material transactions carried out by the company with other entities belonging to the same group, provided that these are not eliminated in the preparation of the consolidated financial statements and do not form part of the company's ordinary business activities in terms of their purpose and conditions.**

**In any event, note any intragroup transaction conducted with entities established in countries or territories which are considered tax havens:**

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**D.5 State the amount of any transactions conducted with other related parties that have not been reported in the previous sections.**

Name of entity within the group	Brief description of the transaction	Amount (thousand euros)
China Unicom	As stated in Note 10 ("Related Parties") of the consolidated accounts of Telefónica, S.A. corresponding to the year 2018, in 2015 a "joint venture" with China Unicom was incorporated, for the development of Big Data Services in China, using the "Smart Steps" technology developed by Telefónica. Telefónica's stake in this Company is 45% through Telefónica Digital España, S.L., with China Unicom Big Data Limited Corporation owning the remaining 55% stake. In 2018 this company obtained a turnover equivalent to 10 million euros. Similarly, the operation consisting of the entry of the company Beijing Jingdong Financial Technology Holding Co., Ltd., controlled by JD.com, in the aforementioned "joint venture" was approved in December 2018, which will result in a capital increase fully to subscribe by Beijing Jingdong Financial Technology Holding Co., Ltd. (17%, approximately) with the consequent dilution of the current shareholders (Telefónica will held about 33%, approximately).	0
Grupo Global Dominion Access	As stated in note 10 ("Related Parties") of the consolidated annual accounts of Telefónica, S.A. corresponding to the year 2018, certain subsidiary companies of the Telefónica Group, in conjunction with the Global Dominion Access Group in the year 2018, transactions arising from the Group's ordinary traffic or business, mainly Telefónica de España, for a total of €25 million.	25.000

**D.6. Describe the mechanisms in place to detect, determine and resolve potential conflicts of interest between the company and/or its group and its directors, senior management or significant shareholders.**

See heading H "Other information of Interest", Note 11 to Section D.6.

**D.7 Is there more than one company in the group listed in Spain?**

No



## E. RISK MANAGEMENT AND CONTROL SYSTEMS

### E.1 Explain the scope of the company's Risk Management and Control System, including tax compliance risk.

Telefónica continually monitors the most significant risks in the main companies comprising its Group. The Company therefore has a Corporate Risk Management Framework, based on the model established by the Treadway Commission's Committee of Sponsoring Organizations (COSO), that allows to evaluate both the impact and the probability of occurrence of the different risks. Likewise, Telefónica continues working on the alignment of its framework with the updated COSO ERM Framework ("Enterprise Risk Management - Integrating with Strategy and Performance"), released in September 2017.

The risk management and control process takes as a starting reference the strategy and the objectives of the Company, as a basis for identifying the main risks, which may affect the achievement of these objectives. Once identified, the risks are evaluated in a qualitative and/or quantitative way in order to prioritize the follow-up and response to them, either through mitigation plans or actions to avoid or transfer those risks.

In order to have a comprehensive model, oriented to the Group's needs and configuration, the Telefónica Risk Management Framework considers a risk assessment with four complementary perspectives: overall (top-down), local (bottom-up) and cross-sectional (projects and processes).

In accordance with this Framework, and based on best practices and benchmarks in risk management, the following four risk categories have been identified:

- **Business risk:** Possible loss of value or earnings resulting from changes in the business environment, the competition and market scenario, the regulatory framework or the strategic uncertainty.
- **Operational risk:** Possible loss of value or earnings as a result of events caused by inadequacies or failures in the network or the IT systems, security, customer service, supply chain, human resources, as well as operational management.
- **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.
- **Global risk:** Possible loss of value or earnings as a result of events that affect in a transversal way the entire Telefónica Group, including sustainability and compliance issues.

### E.2 Identify the bodies within the company responsible for creating and executing the Risk Management and Control System, including tax compliance risk.

In accordance with the Regulations of the Board of Directors of Telefónica S.A., the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties, including the supervision of risk management and control systems, including tax risks. With respect thereto, it shall be responsible for proposing to the Board of Directors a Risk Management and Control Policy, which shall identify at least the following: the types of risk facing the company; the setting of the risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize; and the control and information systems to be used to control and manage the above-mentioned risks.

As stated by the Group's Risk Management and Control Policy, approved by the Board of Directors, various local and corporate units are involved in the risk management and control 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 and control processes.

There is a function independent of the management, within the Internal Audit area, which has an overall structure and local responsible persons, whose mission is to promote, support, coordinate and monitor the implementation of the provisions of this Policy, both at Group level and in its main operations, also assisting the Audit and Control Committee with whatever issue it deems appropriate.

The Group's Fiscal Control Policy, approved by the Board of Directors of the Company in February 2012 and updated in December 2016, establishes the rules for the prevention and management of fiscal risk. The development of the fiscal control function corresponds to the Group's Fiscal Management, which performs this task through the Regional Fiscal Directorates and the local fiscal control officers in the different subsidiaries in accordance with the principles defined in said document.

**E.3 State the primary risks, including tax compliance risks, and those deriving from corruption (with the scope of these risks as set out in Royal Decree Law 18/2017), to the extent that these are significant, which may affect the achievement of business objectives.**

Information regarding this point is contained in the Annex to this Report.

**E.4 State whether the entity has a risk tolerance level, including tolerance for tax compliance 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 reputation, corporate responsibility and compliance.

**E.5 State which risks, including tax compliance risks, have materialised during the year.**

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

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 impairments in goodwill, intangible assets, property, plant and equipment or financial assets. Although the recognition of impairments of these assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations.

In 2018 an impairment of the total goodwill allocated to Telefónica Móviles México has been recognized amounting to 350 million euros. During 2018, the macroeconomic and financial conditions in Mexico changed, which was reflected in the different risk premiums that are taken into account when computing WACC. In this context, the estimated WACC increased to 10.6% (from 9.5% used in the valuation at the end of 2017). Higher competitive market intensity during 2018 has compounded the macroeconomic situation, mainly in the prepayment segment.

Further details on Income tax matters are provided by Telefónica in its Annual Accounts (Note 17 of the Individual and Note 22 of the Consolidated Financial Statements).

**E.6 Explain the response and monitoring plans for all major risks, including tax compliance risks, of the company, as well as the procedures followed by the company in order to ensure that the board of directors responds to any new challenges that arise.**

The Corporate Risk Management Framework, 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. As indicated above, Telefónica's risk management and control model considers its evolution in accordance with the provisions of the COSO ERM framework, "Enterprise Risk Management - Integrating with Strategy and Performance" of 2017 and, 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.

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.

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 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.

As indicated above, the Regulations of the Board of Directors of Telefónica S.A. establish that the Audit and Control Committee will have as its primary function to support the Board of Directors in its supervisory duties, including the supervision of the risk management and control systems, including tax risks. In this sense, the Board of Directors, through the Audit and Control Committee, is periodically informed of the main risks of the group, as well as the response strategies and the associated mitigation plans. Likewise, the Audit and Control Committee periodically reports on these matters to the Board of Directors. Also, specific presentations are made by those responsible for the main areas of risk and the evolution and strategies followed.

## F. INTERNAL RISK MANAGEMENT AND CONTROL SYSTEMS RELATED TO THE PROCESS OF PUBLISHING FINANCIAL INFORMATION (ICFR)

Describe the mechanisms comprising the System of Internal Control over Financial Reporting (ICFR) of your company.

### F.1 Control environment

Report on at least the following, describing their principal features:

#### F.1.1 The bodies and/or departments that are responsible for (i) the existence and maintenance of an adequate and effective ICFR; (ii) their implementation; and (iii) their supervision.

The Board of Directors of Telefónica, S.A. (hereinafter "Telefónica" or the "Company") assumes ultimate responsibility of ensuring that an adequate and effective system of internal control over financial reporting (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, highlighting, among others, the following powers and duties:

- i. Submitting to the Board of Directors proposals for the selection, appointment, re-election and replacement of the external auditor, being responsible for the selection process in accordance with the provisions of the law, as well as the conditions of their engagement, and regularly collecting information from the auditor of the audit plan and its execution, in addition to preserving its independence in the exercise of its functions.
- ii. Supervise the internal audit, and, in particular:
  - a) Ensure the independence and effectiveness of the internal audit function;
  - b) Propose the selection, appointment and removal of the person responsible for the Internal Audit service;
  - c) Propose the budget for that service;
  - d) Review the annual work plan of the internal audit and the annual activity report;
  - e) Receive periodic information on their activities; and
  - f) Verify that senior management takes into account the conclusions and recommendations of its reports.
- iii. Supervise the process of preparing and presenting the mandatory financial information and submit recommendations or proposals to the administration body aimed at safeguarding its integrity. In relation to this, it is responsible for supervising the process of preparation and integrity of the financial information relating to the Company and the Group, reviewing compliance with the regulatory requirements, the appropriate delimitation of the consolidation perimeter, and the correct application of the accounting criteria, reporting to the Board of Directors.
- iv. Supervise the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal ones, as well as discuss with the Auditor Accounts the significant weaknesses of the internal

control system detected in the performance of the audit, without breaking their independence. To this end, where applicable, it may submit recommendations or proposals to the Board of Directors and the corresponding deadline for their follow-up. Additionally, the Board of Directors is the responsible to propose the Risk Control and Management Policy, which will identify, at least:

- a) Risk types (at least, operational, technological, financial, legal and reputational) which the Company faces;
  - b) Setting of the level of risk which the Company considers acceptable; the measures for mitigating the impact of the identified risks should they materialize; and
  - c) Control and information systems to be employed to control and manage those risks.
- v. Establish and supervise a system that enables employees to communicate, in a confidential and anonymous manner, irregularities of potential importance, especially financial and accounting irregularities, that may be noticed within the Company.
  - vi. Establish and maintain the opportune relations with the Auditor to receive information on those issues that may be a threat to the independence of the Auditor, for examination by the Commission, and any other related to the process of developing the audit of accounts, and, when applicable, the authorization of services other than those prohibited, in the terms stated in the applicable legislation, as well as other communications included in the legislation on audit of accounts, and in the auditing standards. In any case, the Audit and Control Committee shall receive annually from the Auditor the declaration of its independence in relation to the entity or entities linked to it directly or indirectly, as well as the detailed and individualized information of the additional services of any type provided and the corresponding fees received from these entities by the aforementioned Auditor, or by the persons or entities linked to them in accordance with the provisions of current regulations.
  - vii. Issue on an annual basis, prior to the issuance of the accounts audit report, a report expressing an opinion on whether the Auditor's independence is compromised. This report must conclude, in any case, on the reasoned assessment of the provision of each and every one of the additional services referred to in point vii above, individually considered and as a whole, other than the legal audit and in relation to the independence regime or with the regulations governing the activity of the accounts audit.
  - viii. Analyse and report the economic conditions, the accounting impact and, if applicable, the exchange ratio proposed for the operations of structural and corporate modifications that the Company plans to carry out, before being submitted to the Board of Directors.
  - ix. Inform, in advance, to the Board of Directors, on all matters stated in the law and the Bylaws, and, in particular, on:
    1. The financial information that the Company must periodically publish;
    2. The creation or acquisition of participations in special purpose entities or domiciled in countries or territories that are considered tax havens; and
    3. Transactions with related parties.
  - x. To exercise, regarding those companies of its Group which are considered Public Interest Entities (as they are defined in the current legislation) as approved by the Board of Directors, provided that they are fully owned, directly or indirectly, by the Company, in accordance with the provisions of current legislation, and which are not attributed to a Board of Directors, all the functions of the Audit Committee contemplated at any time by current legislation.

The provisions abovementioned are understood without prejudice to the regulations governing the audit of accounts.

According to the Regulation of the Board of Directors, the Audit and Control Committee must meet at least once every quarter. In practice, the Committee meets approximately thirteen times throughout the year.

To carry out this supervisory function, the Audit and Control Committee is assisted by the entire Company management, including Internal Audit.

Thus, Internal Audit becomes an independent area in the management of the Company, supporting the Audit and Control Committee in its competences on assurance, risk management, and the internal control system. For this purpose, Internal Audit applies a systematic and orderly approach by the following main lines of action:

- Coordination and review of the consistency of the Internal Regulations of the Telefónica Group.
- Coordination and supervision of the Risk Management System.
- Ongoing Audit.
- Supervision of controls on outflows.
- Reviews or specific audits on the Company processes. Among these activities, the following are included:
  - i) Audits on the internal control over financial reporting, required by the Sarbanes Oxley Act to the US listed companies which also covers the assessment on the system of internal control over financial reporting (ICFR) for companies listed in Spain;
  - ii) Audits on the efficiency and effectiveness of the design and execution of the controls in processes; and
  - iii) Other audits or specific reviews for compliance across the Telefónica Group.
- Reviews or specific audits on the operations and security of networks and information technologies.
- Perform other audits or specific reviews, of interest for the board of directors or the top management of the Company.

All the different areas and functional units of the Telefónica Group are important in ICFR (internal control over financial reporting), the Finance and Control area 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 for executing these tasks.

**F.1.2 State whether the following are present, especially if they relate to the creation of financial information:**

- **Departments and/or mechanisms in charge of: (i) design and review of corporate structure; (ii) clear definition of lines of responsibility and authority with an adequate distribution of tasks and functions; and (iii) assurance that adequate procedures exist for proper communication throughout the entity.**

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 People Division carries out the deployment of the organizational structure in the respective fields.

Use of the Telefónica Group's economic-financial information system is regulated through several manuals, instructions and internal rules and regulations, internally made available, the most noteworthy of which are as follows:

- **Corporate Regulations on the Control, Registration and Reporting of Financial and Accounting Information of the Telefónica Group**, which set out the basic principles of the financial and

accounting reporting system of the Group, and the procedures and mechanisms in place to oversee this system.

- **Accounting Policies Manual, under IFRS, based on IFRS (International Financial Reporting Standards)**, designed to unify and homogenize the accounting policies and criteria used by all the Group companies to ensure Telefónica operates as a consolidated and homogeneous group.
- **Reporting and external audit instructions**, they are published on a quarterly basis and are intended to establish procedures and a calendar to be followed by all the Companies of the Telefónica Group and by their external auditors in the reporting of the financial-accounting information and results of the processes of external audit at the closing of each period, to comply with legal and information obligations of Telefónica, both in Spain and in the rest of the countries where Telefónica's Group shares are listed.
- **Manual for Completion of the Reporting for Consolidation of the Telefónica Group**, which is updated at least annually and establishes specific instructions completing the reporting forms necessary for the preparation of consolidated financial statements and interim consolidated financial information.
- **Annual calendar of financial accounting information**, applicable to all Telefónica Group companies to establish from the start of each period the monthly accounting-financial information reporting dates.
- **Corporate Accounting Plan ("PCC")**, which consists of the following documents: a) Table of accounts; b) Manual of definitions and Accounting Relations; and c) Auxiliary tables. The PCC intends to homogenize the sources of financial information included in the accounts of all the Telefónica Group companies, mandatory for all Companies in the Telefónica Group
- **Corporate Regulations on Intragroup Operations (NCC-006)**, mandatory for all companies in the Telefónica Group, and whose purpose is to recast in a specific regulation the criteria of mandatory compliance with regard to the accounting register and payment of transactions between companies in the Group and reinforce controls to avoid non-compliance cases.

These documents define and delimit responsibilities at each level of the organization regarding the reliability of the information published.

Additionally, the Management levels of the Company are available on the Group Intranet.

- **Code of conduct, the body approving this, degree of dissemination and instruction, including principles and values, (state if there is specific mention of transaction recording and creation of financial information), a body charged with analyzing breaches and proposing corrective actions and sanctions.**

With regard to the Code of Conduct, the Board of Directors of Telefónica approved, in December 2006, the unification of the Codes of Ethics of the Group's companies, in the so-called Business Principles. The Business Principles are applied as a standard in all countries where the Telefónica Group operates and apply to all its employees (the Business Principles affect at all levels of the organization, directors and non-directors).

In 2017, the Board of Directors approved a new version of the Principles which includes an update of the commitments in matters of privacy and security, compliance and fiscal transparency, responsible communication and protection of minor stockholders, among others.

The Responsible Business Principles emanate from three basic values: integrity, commitment and transparency, which are essential values to ensuring the trust that Telefónica wants with its groups of interest.

Regarding the financial information, the following principles are set:

- **Transparency of the information:** we shall provide, immediately and without discrimination, all the relevant information. We are conscious of the importance for all our groups of interest of sharing true,

complete, opportune and clear information in the reports registered with the relevant Supervising Bodies of the Stock Markets, and in other public communications of the company as well.

- Privileged Information: we abstain from using, in our profit or for third parties any privileged information, safeguarding the confidentiality and establishing the controls and processes legally required by the Supervising Bodies of the Stock Markets in all the actions related to those markets.

The Responsible Business Principles are available to all employees via the intranet, and there are update, monitoring and communication procedures of these principles inside the Telefónica Group. Likewise, training programmes are also regularly organized to ensure employees are aware of these rules and Principles.

In this respect, Telefónica has a Corporate Policy on the Integral Discipline Program which intends to define the basic principles of the Group's disciplinary system, providing for homogeneous, objective, proportional and non-arbitrary treatment of all employees, without prejudice to and with absolute respect for the legislation and regulations applicable in each case to the Group companies in the different countries in which they operate.

Telefónica has an Office of Responsible Business Principles, which comprises the most senior representatives of the General Secretary's and Regulation Office, Human Resources, Public Affairs, Chief Commercial Digital Officer (CCDO), Operations, Purchases, Compliance, Internal Audit, Corporate Ethics and Sustainability, Security and Chief Data Officer (CDO).

Among the responsibilities of this Office, the following stand out:

- Guaranteeing that Telefónica conducts business in an ethical and responsible manner, through the follow-up and monitoring of the Responsible Business Plan.
- Propose and supervise initiatives and measures that contribute to compliance with the Principles of Responsible Business in the Group.
- Analyse any matters or proposals in the Group that could represent a risk to the Business Principles and associated policies.

On a different issue should any type of conduct which does not comply with applicable laws, the Responsible Business Principles or 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.

Telefónica also has an "Internal Code of Conduct" for Securities Markets issues, last updated on December 14, 2016, 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.

- **Whistleblower channel, that allows notifications to the audit committee of irregularities of a financial and accounting nature, in addition to potential breaches of the code of conduct and unlawful activities undertaken in the organization, reporting, as the case may be, if this is of a confidential nature.**

With regard to the whistle-blowing channel, as specified in Article 22 of Telefónica, S.A.'s Regulations for the Board of Directors, and in Article 4 of Regulation for the Audit and Control Committee, this 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 a Policy of Management of the Whistleblowing Channel where the basis of the Whistleblowing Channel of the Group are set, by which employees and top managers at the Telefónica Group can communicate any information they become aware of, by any means -formal or not- about the existence of any possible irregularities, acts contrary to legality or the internal regulations; also including eventual irregularities referring to accounting issues, auditing and/or aspects related to the internal control on financial reporting, complying with section 301 of Sarbanes-Oxley Act of the U.S. and other requirements in this sense.



In the Management of the Whistleblowing Channel apply the confidentiality principles of data provided and declarations made, respect and legal basis; so that any decision taken from the reception of a Whistleblow will be reasoned, proportionate and considering the circumstances of the facts denounced, with full respect to the rights and due guarantees for the whistle-blower and the persons affected if there were any.

Any complaint referred to issues about accounting aspects, auditing matters, internal controls on financial Reporting and/or relative to all those questions referred to in the Sarbanes Oxley Act, including any fraud, material or not, affecting the Directorship, and affecting any society in the Group - as well as the result of the Management derived from the audit itself derived in these cases- will be received, in the first instance, by the means established in this Policy, by the Audit and Control Commission of the Board of Directors of Telefónica, and will be forwarded to, when appropriate, the equivalent bodies in other societies in the Group that could be subject in a direct manner to the requirements of the Sarbanes Oxley Act. This transfer will be made through the Internal Audit area and in accordance to the procedure that, to this effect, is set, considering the characteristics of the societies affected and, particularly, in its condition of listed company.

- **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 Consolidation and Accounting Polices 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 summarizing 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 included in the tool Corporate Human Resource management (Success Factor), 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 of the Telefónica Group, a model has been developed to select the most significant processes by applying a so-called Scope Definition Model, which is a part of the internal methodology of internal control audit over financial information. This model is applied to the financial information reported by subsidiaries companies. The model selects the significant sections, i.e., those accounts with the largest contribution to the Group's consolidated financial information and then identifies the processes used to generate this information. Once the relevant processes have been identified, an analysis of those that have the most relevant impact on the significant sections is performed, reviewing the effectiveness of the design and the operation of the key controls that address the main risks or the associated "financial information objectives".

- **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.**

The procedure for identifying and reviewing key controls covers the objectives of the information financial (also called financial premises) of accuracy, valuation, integrity, cut of operations, existence / occurrence, presentation and comparability, as well as breakdown, and rights and obligations. This identification of the key controls, intended to address the aforementioned premises of the significant headings and relevant processes in the scope, is carried out annually. The analysis process is carried out annually, following up during the year to identify relevant changes that must be duly addressed.

- **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 Finance and Control Areas 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, including the corporate departments.

- **The process addresses other types of risk (operational, technological, financial, legal, fiscal, reputational, environmental, etc.) insofar as they may affect the financial statements.**

Telefónica monitors permanently the most significant risks that may affect the main societies comprising the Group. For that, the Company has a Corporate Risk Management Model based on COSO (Committee of Sponsoring Organizations, of the Treadway Commission). Work on the alignment of the Telefónica risk management and control model to the COSO ERM - "Enterprise Risk Management - Integrating with Strategy and Performance" - framework published in September 2017 continues.

The risk management and control process takes as a starting point of reference the strategy and the objectives of the Company, as a basis for the identification of the main risks that may affect its attainment. Once identified, the risks are evaluated in a qualitative and/or quantitative manner with a view to prioritizing their monitoring and response to them, either with mitigation plans or with actions to prevent or transfer those risks.

In order to have an integral model, oriented to the Group needs and its own configuration, the Model of Telefónica contemplates a risk assessment with four complementary perspectives: global (top-down), local (bottom-up) and cross (in projects and by processes).

According to this Model, and based on the references and practices recognized in risk Management, four risk categories have been defined:

- Business: possible loss of value or results derived from changes in the business environment, the situation of the competence and the market, changes in the regulations framework or strategic uncertainty.
- Operational: possible loss of value or results derived from events caused by the inadequacy or failures from the networks or computing systems, security, customer care, the supply chain, human resources, as well as operating management.
- Financial: possible loss of value or results derived from the adverse movements in financial variables, and the inability of the company to face its commitments or liquidate assets. Likewise, risks of a fiscal nature are also included in this category.
- Global: possible loss of value or results derived from the events that affect in a cross-cutting manner the Telefónica Group, including sustainability and compliance issues.

- **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, the 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 Consolidation and Accounting Policies 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 or Chief Executive Officers and the Finance Directors of Group companies must submit a certificate to the Corporate Consolidation and Accounting Policies 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 Consolidation and Accounting Policies 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 Consolidation and Accounting Policies 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 Consolidation and Accounting Policies 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, among other actions, sets out work plans every year to assess the internal control of financial reporting model.

**F.3.2. Internal control policies and procedures for information systems (including secure access, control of changes, system operation, operational continuity and segregation of duties) giving support to key company processes regarding the preparation and publication of financial information.**

The Global Security Policy considers an integral concept of the physical and operational security of human resources the information, technologies, cybersecurity, and material resources that support them to be fundamental assets with the purpose of guaranteeing the corporate protection against potential damage or eventual loss. For this reason, guaranteeing the Group security is considered an essential aspect within the Telefónica strategy, and an essential enabler of the organization's activity.

With the approval of this Policy, the Board of Directors expresses its determination and commitment to reaching a level of security that is adequate to the needs of the business and that homogeneously guarantees the protection of the assets in all Telefónica Group companies.

In this context, the Global Security Directorship is responsible of defining and promoting the implementation of security policies and standards applicable in the Telefónica Group, understanding security as an integral concept. These politics and standards are intended to preserve the assets and protect the strategic interests and objectives of the Telefónica Group, in its vertical organization (including its business units) as well as in its cross-cutting dimension (applicable to all its four platforms): (1) infrastructure and network assets, (2) information technologies, (3) products and services, and (4) data; with them confidentiality and integrity of the assets and interests and strategic objectives of the Telefónica Group are guaranteed, protecting them from potential actions that could affect their availability, damage their value, reduce their efficiency or affect their operability. The Global Security Directorship is also in charge of measuring the level of implementation of the Global Security Regulations Framework and supervising the state of the security on an ongoing basis.

The Global Directorship of Networks and Information Systems of the Telefónica Group is responsible of the integral Management of Information Systems for all the Group businesses, defining the technologic strategy and planning and ensuring the compliance with the conditions of service quality, expenditure and security required by the Group. Among its various functions are the development and implementation of systems that improve the efficiency, effectiveness and profitability of the processes in the Group, and the implementation of security policies and standards on applications and infrastructures (defined by the Global Security Directorship), including the internal control model for security in the field of information technologies.

The security activities developed by the different environments, organizational structures, parties responsible for assets, and employees will be governed by the principles of legality, efficiency, co-responsibility, cooperation, and coordination. Any and all adequate promotion, conduction, control, and improvement measures will be established to this end.

- **Principle of Legality:** the necessary compliance of all national and international laws and regulations regarding the matter of security that may be valid at any given time in any of the territories where the Telefónica Group operates, shall be ensured.
- **Principle of Efficiency:** in order to efficiently reach the required level of security, the anticipatory and preventive nature of said actions shall rule over any passive and reactionary nature. To this end, knowledge of potential threats as well as the analysis of potential risks shall be privileged as part of an intelligence process that identifies and understands the most relevant threats that affect the organization. The objective is to get ahead of their action and evolution, and to safeguard the Telefónica Group's global organization from their potentially harmful effects, mitigating these risk's damages down to an acceptable level for the business.

A Global Security Regulations Framework is defined for reaching a standardized level of security. This framework will take into consideration the analyses of risks and threats and will also establish the precise preventive or corrective protection measures.

In addition, strategic plans will be conceived and prepared to identify and prioritize the projects and budgets necessary for reaching those adequate levels of security and auditability, minimizing the security risks identified in the corresponding analyses, and maximizing the effectiveness of the investment made and the resources used.

- **Principle of Co-responsibility:** users must preserve the security of the assets that Telefónica makes available to them in accordance to the security criteria, requirements, procedures, and technologies defined in the Security Regulations Framework, as well as the applicable laws and regulations regarding the matter of security. At the same time, users must exclusively use the assets for the performance of activities that correspond to their workstation and assigned tasks.
- **Principle of Cooperation and Coordination:** to reach the levels of efficiency required by Telefónica business project, the global action and comprehensive concept of security activities shall be preserved together with the aforementioned requirements of anticipation and prevention, cooperation and

coordination between all business units and employees will be prioritized, in order to generate the adequate synergies and to jointly reinforce the capabilities.

The Security Organization coordinates the security responsibilities of the different Telefónica Group structures, promoting cooperation between them to guarantee the efficient and joint protection of the assets.

Lastly, Internal Audit unit, within the scope established in its annual audit plan, sets out work plans to verify the efficacy and efficiency of the IT governance model, the information security Policy, 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 an appropriate 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 carried out by Internal Audit, on certain administrative outsourced processes, with the scope established in its annual audit plan.

When Telefónica, S.A. or any of its subsidiaries engage the services of an independent expert whose findings may potentially show impacts on the consolidated financial statements, as part of the selection process the competence, training, credentials and independence of the third party about the methods and main hypothesis used, is verified directly by the area contracting the service and, if applicable with the procurement department. The Finance and Control 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 (Key Performance Indicators) 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 Consolidation and Accounting Policies 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 summarizing the main changes to accounting methodology, as well as clarifications on various other related issues, which are systematically monitored by the Accounting Policies area. These 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 June 2018. 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 for sharing best practices between operators, too.

#### **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.**

As stated above, there is a Compliance Manual for Consolidation Reporting which includes specific instructions on preparing the disclosures which comprise the reporting pack reported by all components of the Telefónica Group for the preparation of the Telefónica Group's consolidated financial statements and the consolidated explanatory notes.

Likewise, the Telefónica Group has implemented a specific system, through a software, which supports 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 all components of the Telefónica Group use 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 above, 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, being within its remit the supervision of the effectiveness of the Company's internal control system and risk management and control systems and discussing with the Auditors significant or material weaknesses in the internal control system detected during the audit.

Telefónica has an Internal Control Policy that sets that the Board of Directors, via the Audit and Control Committee, supervises the internal control system, with the support of the Internal Audit unit of the Telefónica Group. In that Policy the "internal control" is defined as the process performed by the Board of Directors, the Directorship and the rest of the staff of the Company, being designed with the purpose of providing with a reasonable assurance degree for the attainment of the objectives related to operations, information and compliance. With the purpose of helping to the achievement of its objectives, the Company has an internal control model defined in line with what is set out in the Integrated Framework of Internal Control of the "Committee of Sponsoring Organizations of the Treadway Commission" (COSO).

Likewise, there exists a Policy of Organization of Internal Audit which includes aspects referred to the organization and its functioning of this area.

According to what is set in that Policy, Internal Audit is the area in Telefónica in charge of confirming, by means of appropriate evidence, the adequate functioning of the internal control structures and risk management and, being the case, detecting the possible inefficiencies or non-compliance with the control system that the Group establishes in its processes. This manner, Internal Audit becomes an area independent from the Company management that supports the Audit and Control Commission in its competences on assurance, risk management and internal control system.

The Internal Audit function is carried out in accordance with 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 the said 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. To fulfil this requirement, the Telefónica Group has an internal control of financial reporting evaluation model, being the Internal Audit responsible of performing the assessment of its effectiveness on an annual basis.

Additionally, as set in this law, the External Auditor issues its own independent opinion on the effectiveness of the internal control over financial information (ICFR).

#### **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 of the Telefónica Group, which in turn uses the Definition of Scopes Model, in order to identify the significant accounts of each company of the Telefónica Group in accordance with the previously established criteria for the assessment of the internal control over financial information (ICFR) at the Telefonica Group level.

Once the significant accounts are identified for review, the General Evaluation Model is applied as follows:

- The processes and systems associated with the significant 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 design and execution of key control activities, both at process or transaction level and general entity level controls.

#### **Review on IT general controls**

The Information Technology General Controls are assessed at least once a year, largely taking into account questions regarding regulations and guidelines applied at global level across the Group.

The supervision of IT general controls systems is designed to review management of changes to programs, data and systems access, and the operation (management of changes to infrastructures, back-ups, scheduled tasks and issues).

#### **Self-assessment Questionnaires**

All the subsidiaries of the Group receive annual self-assessment questionnaires, whose answers should be certified by the responsible of the Internal Control Over Financial Reporting (ICFR) System, in each company (Chief Executives or Chief Executive Officer (CEO) and Chief Financial Officer (CFO)). These questionnaires cover those ICFR aspects that are deemed to be minimum requirements to achieve reasonable assurance of the reliability of the financial information reported. A sample of responses is audited by the Internal Audit unit.

If any control deficiency or opportunity for improvement is detected while performing the procedures mentioned above, they should be reported to Management through reports prepared by the Internal Audit unit, analysing their impact, both individual and aggregated, on the assessment on the internal control over financial information (ICFR) if applicable. Additionally, for this assessment, it is necessary to consider the existing compensating controls which validate the processes supported in case that the original controls could not be corrected. After receiving the report, the control owners provide action plans for solving the identified control deficiencies, as well as the foreseen implementation dates of those action plans.

These action plans have as main objectives:

- Mitigate the deficiency from the control defined originally so that the control works as expected.
- Prioritize the implementation of improvement opportunities, since improvement opportunities are not internal control deficiencies.

**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 deficiencies 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 of the degree of implementation thereof. This includes to communicate significant or material internal control deficiencies which have been identified, as well as the follow up of the action plan linked to them.

Furthermore, the External Auditor participates in the Audit and Control Committee meetings, when called to do so by the Audit and Control 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 is obliged to communicate the significant or material internal control weaknesses identified and, for this purpose, has immediate access to the Senior management and the Chairman of the Audit and Control Committee.

**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.**

As stated above, 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. EXTENT OF COMPLIANCE WITH CORPORATE GOVERNANCE RECOMMENDATIONS

Specify the company's level of compliance with recommendations from the Unified Code of Good Governance.

In the event that a recommendation is not followed or only partially followed, a detailed explanation should be included explaining the reasons in such a manner that shareholders, investors and the market in general have enough information to judge the company's actions. General explanations are not acceptable.

- 1. That the Articles of Association of listed companies do not limit the maximum number of votes that may be cast by one shareholder or contain other restrictions that hinder the takeover of control of the company through the acquisition of shares 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 the majority support of all shareholders, because, naturally, and as taught by experience, potential offerers 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 offerer has a stake equal to or over 70% of the share capital which confers voting rights, unless the offerer 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 Operating 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. **That when the parent company and a subsidiary are listed on the stock market, both should publicly and specifically define:**
  - a) **The respective areas of activity and possible business relationships between them, as well as those of the listed subsidiary with other group companies.**
  - b) **The mechanisms in place to resolve any conflicts of interest that may arise.**

Not applicable

3. **That, during the course of the ordinary General Shareholders' Meeting, complementary to the distribution of a written Annual Corporate Governance Report, the chairman of the Board of Directors makes a detailed oral report to the shareholders regarding the most material aspects of corporate governance of the company, and in particular:**
  - a) **Changes that have occurred since the last General Shareholders' Meeting.**
  - b) **Specific reasons why the company did not follow one or more of the recommendations of the Code of Corporate Governance and, if so, the alternative rules that were followed instead.**

Complies

4. **That the company has defined and promoted a policy of communication and contact with shareholders, institutional investors and proxy advisors that complies in all aspects with rules preventing market abuse and gives equal treatment to similarly situated shareholders.**

**And that the company has made such a policy public through its web page, including information related to the manner in which said policy has been implemented and the identity of contact persons or those responsible for implementing it.**

Complies

5. **That the Board of Directors should not propose to the General Shareholders' Meeting any proposal for delegation of powers allowing the issuance of shares or convertible securities without pre-emptive rights in an amount exceeding 20% of equity at the time of delegation.**

**And that whenever the Board of Directors approves any issuance of shares or convertible securities without pre-emptive rights the company immediately publishes reports on its web page regarding said exclusions as referenced in applicable company law.**

Complies

6. **That listed companies which draft reports listed below, whether under a legal obligation or voluntarily, publish them on their web page with sufficient time before the General Shareholders' Meeting, even when their publication is not mandatory:**
- a) **Report regarding the auditor's independence.**
  - b) **Reports regarding the workings of the audit committee and the appointments and remuneration committee.**
  - c) **Report by the audit committee regarding related-party transactions**
  - d) **Report on the corporate social responsibility policy.**

Complies

7. **That the company reports in real time, through its web page, the proceedings of the General Shareholders' Meetings.**

**Explain**

The Company has not considered it appropriate to transmit, live through its website, the complete celebration of the General Shareholders' Meeting according to organisational reasons and development of the event (the tampering that might have occurred). However, the Chairman's speech at the General Shareholders' Meeting held on June 8, 2018 was broadcast via streaming.

8. **That the audit committee ensures that the Board of Directors presents financial statements in the audit report for the General Shareholders' Meetings which do not have qualifications or reservations and that, in the exceptional circumstances in which qualifications may appear, that the chairman of the audit committee and the auditors clearly explain to the shareholders the content and scope of said qualifications or reservations.**

Complies

9. **That the company permanently maintains on its web page the requirements and procedures for certification of share ownership, the right of attendance at the General Shareholders' Meetings, and the exercise of the right to vote or to issue a proxy.**

**And that such requirements and procedures promote attendance and the exercise of shareholder rights in a non-discriminatory fashion.**

Complies

10. **That when a verified shareholder has exercised his right to make additions to the agenda or to make new proposals to it with sufficient time in advance of the General Shareholders' Meeting, the company:**

- a) Immediately distributes the additions and new proposals.
- b) Publishes the attendance card credential or proxy form or form for distance voting with the changes such that the new agenda items and alternative proposals may be voted upon under the same terms and conditions as those proposals made by the Board of Directors.
- c) Submits all of these items on the agenda or alternative proposals to a vote and applies the same voting rules to them as are applied to those drafted by the Board of Directors including, particularly, assumptions or default positions regarding votes for or against.
- d) That after the General Shareholders' Meeting, a breakdown of the results of said additions or alternative proposals is communicated.

Not applicable

11. That, in the event the company intends to pay for attendance at the General Shareholders' Meeting, it establish in advance a general policy of long-term effect regarding such payments.

Not applicable

12. That the Board of Directors completes its duties with a unity of purpose and independence, treating all similarly situated shareholders equally and that it is guided by the best interests of the company, which is understood to mean the pursuit of a profitable and sustainable business in the long term, and the promotion of continuity and maximisation of the economic value of the business.

And that in pursuit of the company's interest, in addition to complying with applicable law and rules and in engaging in conduct based on good faith, ethics and a respect for commonly accepted best practices, it seeks to reconcile its own company interests, when appropriate, with the interests of its employees, suppliers, clients and other stakeholders, as well as the impact of its corporate activities on the communities in which it operates and the environment.

Complies

13. That the Board of Directors is of an adequate size to perform its duties effectively and collegially, and that its optimum size is between five and fifteen members.

Explain

In accordance with article 29 of the Telefónica, S.A. corporate bylaws, the Board of Directors shall be composed of a minimum of five and a maximum of twenty members. However, in line with the Good Governance tendencies to reduce the number of Board Members, the General Shareholder's Meeting held on June 9, 2017 approved the establishment of seventeen members as the number of Board of Directors members, based on the recommendation of the Company Board of Directors and the favorable report of the Nominating, Compensation and Corporate Governance Committee.

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.

Likewise, it is important to bear in mind that the Board of Directors of the Company have six Committees (the Executive Commission and five Advisory Committees), which ensures the active participation of all its Directors.

**14. That the Board of Directors approves a selection policy for directors that:**

- a) Is concrete and verifiable.**
- b) Ensures that proposals for appointment or re-election are based upon a prior analysis of the needs of the Board of Directors.**
- c) Favors diversity in knowledge, experience and gender.**

**That the resulting prior analysis of the needs of the Board of Directors is contained in the supporting report from the appointments committee published upon a call from the General Shareholders' Meeting submitted for ratification, appointment or re-election of each director.**

**And that the selection policy for directors promotes the objective that by the year 2020 the number of female directors accounts for at least 30% of the total number of members of the Board of Directors.**

**The appointments committee will annually verify compliance with the selection policy of directors and explain its findings in the Annual Corporate Governance Report.**

**Complies**

**15. That proprietary and independent directors constitute a substantial majority of the Board of Directors and that the number of executive directors is kept at a minimum, taking into account the complexity of the corporate group and the percentage of equity participation of executive directors.**

**Complies**

**16. That the percentage of proprietary directors divided by the number of non-executive directors is no greater than the proportion of the equity interest in the company represented by said proprietary directors and the remaining share capital.**

**This criterion may be relaxed:**

- a) In companies with a high market capitalization in which interests that are legally considered significant are minimal.**
- b) In companies where a diversity of shareholders is represented on the Board of Directors without ties among them.**

**Explain**

The aforementioned recommendation 16 refers to the composition of the group of non executive Directors. As stated in Section C.1.3 of this Annual Corporate Governance Report, at December 31, 2018, the group of non Executive Directors of Telefónica, S.A. was composed of 15 members (of a total of 17 Members), of whom 5 are Proprietary Directors, 9 are Independent Directors and 1 falls under the "Other External Directors" category.

Out of the five Proprietary Directors, two represent or have been proposed by CaixaBank, S.A. (CaixaBank), the holder of 5.01% of the share capital of Telefónica, S.A.; another two represent or have been proposed by Banco Bilbao Vizcaya Argentaria, S.A., holder of 5.28% of the share capital; and one represents or has been proposed by China Unicom (Hong Kong) Limited (China Unicom), holder of 1.24% of the share capital.

Applying the proportional criterion established in Article 243 of the LSC regarding the total number of Directors, the stakes held by CaixaBank 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 38,105 million euros at December 31, 2018, which means a very high absolute value of the stakes of CaixaBank and BBVA in Telefónica (that of CaixaBank was around 1,909 million euros, and that of BBVA was around 2,012 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. The Director currently representing or appointed by China Unicom was appointed by the Company's General Shareholders' Meeting held on May 12, 2016.

**17. That the number of independent directors represents at least half of the total number of directors.**

**Nonetheless, when the company does not have a high level of market capitalisation or in the event that it is a high cap company with one shareholder or a group acting in a coordinated fashion who together control more than 30% of the company's equity, the number of independent directors represents at least one third of the total number of directors.**

Complies

**18. That companies publish and update the following information regarding directors on the company website:**

- a) Professional profile and biography.
- b) Any other Boards to which the director belongs, regardless of whether the companies are listed, as well as any other remunerated activities engaged in, regardless of type.
- c) Category of directorship, indicating, in the case of individuals who represent significant shareholders, the shareholder that they represent or to which they are connected.
- d) The date of their first appointment as a director of the company's Board of Directors, and any subsequent re-election.
- e) The shares and options they own.

Complies

**19. That the Annual Corporate Governance Report, after verification by the appointments committee, explains the reasons for the appointment of proprietary directors at the proposal of the shareholders whose equity interest is less than 3%. It should also explain, where applicable, why formal requests from shareholders for membership on the Board meeting**

were not honored, when their equity interest is equal to or exceeds that of other shareholders whose proposal for proprietary directors was honored.

Complies

20. That proprietary directors representing significant shareholders must resign from the Board if the shareholder they represent disposes of its entire equity interest. They should also resign, in a proportional fashion, in the event that said shareholder reduces its percentage interest to a level that requires a decrease in the number of proprietary directors representing this shareholder.

Complies

21. That the Board of Directors may not propose the dismissal of any independent director before the completion of the director's term provided for in the Articles of Association unless the Board of Directors finds just cause and a prior report has been prepared by the appointments committee. Specifically, just cause is considered to exist if the director takes on new duties or commits to new obligations that would interfere with his or her ability to dedicate the time necessary for attention to the duties attendant to his post as a director, fails to complete the tasks inherent to his or her post, or enters into any of the circumstances which would cause the loss of independent status in accordance with applicable law.

The dismissal of independent directors may also be proposed as a result of a public share offer, joint venture or similar transaction entailing a change in the shareholder structure of the company, provided that such changes in the structure of the Board are the result of the proportionate representation criteria provided for in Recommendation 16.

Complies

22. That companies establish rules requiring that directors inform the Board of Directors and, where appropriate, resign from their posts, when circumstances arise which may damage the company's standing and reputation. Specifically, directors must be required to report any criminal acts with which they are charged, as well as the consequent legal proceedings.

And that should a director be indicted or tried for any of the offenses set out in company law legislation, the Board of Directors must investigate the case as soon as possible and, based on the particular situation, decide whether the director should continue in his or her post. And that the Board of Directors must provide a reasoned written account of all these events in its Annual Corporate Governance Report.

Complies

23. That all directors clearly express their opposition when they consider any proposal submitted to the Board of Directors to be against the company's interests. This particularly applies to independent directors and directors who are unaffected by a potential conflict of interest if the decision could be detrimental to any shareholders not represented on the Board of Directors.

Furthermore, when the Board of Directors makes significant or repeated decisions about which the director has serious reservations, the director should draw the appropriate conclusions and, in the event the director decides to resign, explain the reasons for this decision in the letter referred to in the next recommendation.

This recommendation also applies in the case of the secretary of the Board of Directors, despite not being a director.

Complies

24. That whenever, due to resignation or any other reason, a director leaves before the completion of his or her term, the director should explain the reasons for this decision in a letter addressed to all the directors of the Board of Directors. Irrespective of whether the resignation has been reported as a relevant fact, it must be included in the Annual Corporate Governance Report.

Complies

25. That the appointments committee ensures that non-executive directors have sufficient time in order to properly perform their duties.

And that the Board rules establish the maximum number of company Boards on which directors may sit.

Complies

26. That the Board of Directors meet frequently enough so that it may effectively perform its duties, at least eight times per year, following a schedule of dates and agenda established at the beginning of the year and allowing each director individually to propose items do not originally appear on the agenda.

Complies

27. That director absences only occur when absolutely necessary and are quantified in the Annual Corporate Governance Report. And when absences occur, that the director appoints a proxy with instructions.

Complies

28. That when directors or the secretary express concern regarding a proposal or, in the case of directors, regarding the direction in which the company is headed and said concerns are not resolved by the Board of Directors, such concerns should be included in the minutes, upon a request from the protesting party.

Complies



29. That the company establishes adequate means for directors to obtain appropriate advice in order to properly fulfill their duties including, should circumstances warrant, external advice at the company's expense.

Complies

30. That, without regard to the knowledge necessary for directors to complete their duties, companies make refresher courses available to them when circumstances require

Complies

31. That the agenda for meetings clearly states those matters about which the Board of Directors are to make a decision or adopt a resolution so that the directors may study or gather all relevant information ahead of time.

When, under exceptional circumstances, the chairman wishes to bring urgent matters for decision or resolution before the Board of Directors which do not appear on the agenda, prior express agreement of a majority of the directors shall be necessary, and said consent shall be duly recorded in the minutes.

Complies

32. That directors shall be periodically informed of changes in equity ownership and of the opinions of significant shareholders, investors and rating agencies of the company and its group.

Complies

33. That the chairman, as the person responsible for the efficient workings of the Board of Directors, in addition to carrying out his duties required by law and the Articles of Association, should prepare and submit to the Board of Directors a schedule of dates and matters to be considered; organise and coordinate the periodic evaluation of the Board as well as, if applicable, the chief executive of the company, should be responsible for leading the Board and the effectiveness of its work; ensuring that sufficient time is devoted to considering strategic issues, and approve and supervise refresher courses for each director when circumstances so dictate.

Complies

34. That when there is a coordinating director, the Articles of Association or the Board rules should confer upon him the following competencies in addition to those conferred by law: chairman of the Board of Directors in the absence of the chairman and deputy chairmen, should there be any; reflect the concerns of non-executive directors; liaise with investors and shareholders in order to understand their points of view and respond to their concerns, in particular as those concerns relate to corporate governance of the company; and coordinate a succession plan for the chairman.

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**Complies**

35. That the secretary of the Board of Directors should pay special attention to ensure that the activities and decisions of the Board of Directors take into account the recommendations regarding good governance contained in this Code of Good Governance and which are applicable to the company.

**Complies**

36. That the Board of Directors meet in plenary session once a year and adopt, where appropriate, an action plan to correct any deficiencies detected in the following:
- a) The quality and efficiency of the Board of Directors' work.
  - b) The workings and composition of its committees.
  - c) Diversity of membership and competence of the Board of Directors.
  - d) Performance of the chairman of the Board of Directors and the chief executive officer of the company.
  - e) Performance and input of each director, paying special attention to those in charge of the various Board committees.

In order to perform its evaluation of the various committees, the Board of Directors will take a report from the committees themselves as a starting point and for the evaluation of the Board, a report from the appointments committee.

Every three years, the Board of Directors will rely upon the assistance of an external advisor for its evaluation, whose independence shall be verified by the appointments committee.

Business relationships between the external adviser or any member of the adviser's group and the company or any company within its group shall be specified in the Annual Corporate Governance Report.

The process and the areas evaluated shall be described in the Annual Corporate Governance Report.

**Complies**

37. That if there is an executive committee, the proportion of each different director category must be similar to that of the Board itself, and its secretary must be the secretary of the Board.

**Partially complies**

The percentage of independent Directors is greater in the Board of Directors than in the Executive Commission. This is mainly due to the re-classification in 2018 of one of the members of the Executive Commission, Mr Peter Erskine, who passed from being considered an Independent Board Member to "other external" once he reached 12 years as Board Member of the Company. The Company has considered that this change in the classification of one of the members of the Commission, by the mere passage of time, does not justify in and of itself the

modification of the makeup of the Executive Commission. In addition, the fact that the Executive Commission, as is common practice, has a number of members much smaller than the Board makes the indicated change in the classification have a greater impact in the former, more so than in the latter. In any case, Telefónica considers that all categories of Directors are adequately represented in the Executive Commission, and that the differences in the percentages of participation of independent, executive, and other external Directors do not prevent this Committee from exercising its duties with a similar perspective to that of the Board.

- 38. That the Board of Directors must always be aware of the matters discussed and decisions taken by the executive committee and that all members of the Board of Directors receive a copy of the minutes of meetings of the executive committee.**

Complies

- 39. That the members of the audit committee, in particular its chairman, are appointed in consideration of their knowledge and experience in accountancy, audit and risk management issues, and that the majority of its members be independent directors.**

Complies

- 40. That under the supervision of the audit committee, there must be a unit in charge of the internal audit function, which ensures that information and internal control systems operate correctly, and which reports to the non-executive chairman of the Board or of the audit committee.**

Complies

- 41. That the person in charge of the group performing the internal audit function should present an annual work plan to the audit committee, reporting directly on any issues that may arise during the implementation of this plan, and present an activity report at the end of each year.**

Complies

- 42. That in addition to the provisions of applicable law, the audit committee should be responsible for the following:**

**1. With regard to information systems and internal control:**

**a) Supervise the preparation and integrity of financial information relative to the company and, if applicable, the group, monitoring compliance with governing rules and the appropriate application of consolidation and accounting criteria.**

**b) Ensure the independence and effectiveness of the group charged with the internal audit function; propose the selection, appointment, re-election and dismissal of the head of internal audit; draft a budget for this department; approve its goals and work plans, making sure that its activity is focused primarily on material risks to the company; receive periodic information on its activities; and verify that senior management takes into account the conclusions and recommendations of its reports.**

c) Establish and supervise a mechanism that allows employees to report confidentially and, if appropriate, anonymously, any irregularities with important consequences, especially those of a financial or accounting nature, that they observe in the company.

2. With regard to the external auditor:

a) In the event that the external auditor resigns, examine the circumstances which caused said resignation.

b) Ensure that the remuneration paid to the external auditor for its work does not compromise the quality of the work or the auditor's independence.

c) Insist that the company file a relevant fact with the CNMV when there is a change of auditor, along with a statement on any differences that arose with the outgoing auditor and, if applicable, the contents thereof.

d) Ensure that the external auditor holds an annual meeting with the Board of Directors in plenary session in order to make a report regarding the tasks accomplished and regarding the development of its accounting and risks faced by the company.

e) Ensure that the company and the external auditor comply with applicable rules regarding the rendering of services other than auditing, proportional limits on the auditor's billing, and all other rules regarding the auditor's independence.

Complies

43. That the audit committee may require the presence of any employee or manager of the company, even without the presence of any other member of management.

Complies

44. That the audit committee be kept abreast of any corporate and structural changes planned by the company in order to perform an analysis and draft a report beforehand to the Board of Directors regarding economic conditions and accounting implications and, in particular, any exchange ratio involved.

Complies

45. That the risk management and control policy identify, as a minimum:

a) The various types of financial and non-financial risks (among those operational, technological, legal, social, environmental, political and reputational) which the company faces, including financial or economic risks, contingent liabilities and other off balance sheet risks.

b) Fixing of the level of risk the company considers acceptable.

c) Means identified in order to minimize identified risks in the event they transpire.

d) Internal control and information systems to be used in order to control and manage identified risks, including contingent liabilities and other off balance sheet risks.

**Complies**

46. **That under the direct supervision of the audit committee or, if applicable, of a specialised committee of the Board of Directors, an internal control and management function should exist delegated to an internal unit or department of the company which is expressly charged with the following responsibilities:**
- a) Ensure the proper functioning of risk management and control systems and, in particular, that they adequately identify, manage and quantify all material risks that may affect the company.**
  - b) Actively participate in the creation of the risk strategy and in important decisions regarding risk management.**
  - c) Ensure that the risk management and control systems adequately mitigate risks as defined by policy issued by the Board of Directors.**

**Complies**

47. **That members of the appointment and remuneration committee -- or of the appointments committee and the remuneration committee if they are separate - are chosen taking into account the knowledge, ability and experience necessary to perform the duties they are called upon to carry out and that the majority of said members are independent directors.**

**Complies**

48. **That high market capitalization companies have formed separate appointments 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.

The Board of Directors of Telefónica, S.A. has not considered appropriate, so far, 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). Furthermore, it is noted that the Board of Directors currently has five Consultative Committees (Audit and Control Committee, the Nominating, Compensation and Corporate Governance Committee, Regulation and Institutional Affairs Committee, Service Quality and Customer Care Committee and the Strategy and Innovation Committee), in addition to the Executive Commission.

In this context, the separation of the Nominating, Compensation and Corporate Governance Committee would not have been appropriate with the facilitating objective of the reorganization of the Consultative or Committees of the Company, approved by the Board of Directors on April 27, 2016, generating unnecessary inefficiencies and needs for additional allocations.

49. That the appointments committee consult with the chairman of the Board of Directors and the chief executive of the company, especially in relation to matters concerning executive directors.

And that any director may ask the appointments committee to consider potential candidates he or she considers appropriate to fill a vacancy on the Board of Directors.

Complies

50. That the remuneration committee exercises its functions independently and that, in addition to the functions assigned to it by law, it should be responsible for the following:

- a) Propose basic conditions of employment for senior management.
- b) Verify compliance with company remuneration policy.
- c) Periodically review the remuneration policy applied to directors and senior managers, including remuneration involving the delivery of shares, and guarantee that individual remuneration be proportional to that received by other directors and senior managers.
- d) Oversee that potential conflicts of interest do not undermine the independence of external advice rendered to the Board.
- e) Verify information regarding remuneration paid to directors and senior managers contained in the various corporate documents, including the Annual Report on Director Remuneration.

Complies

51. That the remuneration committee consults with the chairman and the chief executive of the company, especially in matters relating to executive directors and senior management.

Complies

52. That the rules regarding composition and workings of supervision and control committees appear in the rules governing the Board of Directors and that they are consistent with those that apply to mandatory committees in accordance with the recommendations above, including:

- a) That they are comprised exclusively of non-executive directors, with a majority of them independent.
- b) That their chairmen be independent directors.
- c) That the Board of Directors select members of these committees taking into account their knowledge, skills and experience and the duties of each committee; discuss their proposals and reports; and detail their activities and accomplishments during the first plenary session of the Board of Directors held after the committee's last meeting.
- d) That the committees be allowed to avail themselves of outside advice when they consider it necessary to perform their duties.
- e) That their meetings be recorded and the minutes be made available to all directors.

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, also, in the Regulation of the Audit and Control Committee) 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 Committee is composed of four independent Directors, and one with the category of "Other external".

2. The Board of Directors has other Consulting Committees which are allocated other functions (Regulation and Institutional Affairs Committee, Service Quality and Customer Service Committee, and Strategy and Innovation Committee), 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 with respect to those that 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 rather 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. That verification of compliance with corporate governance rules, internal codes of conduct and social corporate responsibility policy be assigned to one or split among more than one committee of the Board of Directors, which may be the audit committee, the appointments committee, the corporate social responsibility committee in the event that one exists, or a special committee created by the Board of Directors pursuant to its powers of self-organization, which at least the following responsibilities shall be specifically assigned thereto:**

**a) Verification of compliance with internal codes of conduct and the company's corporate governance rules.**

**b) Supervision of the communication strategy and relations with shareholders and investors, including small- and medium-sized shareholders.**

**c) The periodic evaluation of the suitability of the company's corporate governance system, with the goal that the company promotes company interests and take into account, where appropriate, the legitimate interests of other stakeholders.**

**d) Review of the company's corporate social responsibility policy, ensuring that it is orientated towards value creation.**

**e) Follow-up of social responsibility strategy and practice, and evaluation of degree of compliance.**

**f) Supervision and evaluation of the way relations with various stakeholders are handled.**

**g) Evaluation of everything related to non-financial risks to the company, including operational, technological, legal, social, environmental, political and reputational.**

**h) Coordination of the process of reporting on diversity and reporting non-financial information in accordance with applicable rules and international benchmarks.**

**Complies**

**54. That the corporate social responsibility policy include principles or commitments which the company voluntarily assumes regarding specific stakeholders and identifies, as a minimum:**

**a) The objectives of the corporate social responsibility policy and the development of tools to support it.**

**b) Corporate strategy related to sustainability, the natural environment and social issues.**

**c) Concrete practices in matters related to: shareholders, employees, clients, suppliers, social issues, the natural environment, diversity, fiscal responsibility, respect for human rights, and the prevention of unlawful conduct.**

**d) Means or systems for monitoring the results of the application of specific practices described in the immediately preceding paragraph, associated risks, and their management.**

**e) Means of supervising non-financial risk, ethics, and business conduct.**

**f) Communication channels, participation and dialogue with stakeholders.**

**g) Responsible communication practices that impede the manipulation of data and protect integrity and honor.**

**Complies**

**55. That the company reports, in a separate document or within the management report, on matters related to corporate social responsibility, following internationally recognised methodologies.**

**Complies**

**56. That director remuneration be sufficient in order to attract and retain directors who meet the desired professional profile and to adequately compensate them for the dedication, qualifications and responsibility demanded of their posts, while not being so excessive as to compromise the independent judgment of non-executive directors.**

**Complies**

**57. That only executive directors receive remuneration linked to corporate results or personal performance, as well as remuneration in the form of shares, options or rights to shares or instruments whose value is indexed to share value, or long-term savings plans such as pension plans, retirement accounts or any other retirement plan.**



Shares may be given to non-executive directors under the condition that they maintain ownership of the shares until they leave their posts as directors. The forgoing shall not apply to shares that the director may be obliged sell in order to meet the costs related to their acquisition.

Complies

58. That as regards variable remuneration, the policies incorporate limits and administrative safeguards in order to ensure that said remuneration is in line with the work performance of the beneficiaries and are not based solely upon general developments in the markets or in the sector in which the company operates, or other similar circumstances.

And, in particular, that variable remuneration components:

- a) Are linked to pre-determined and measurable performance criteria and that such criteria take into account the risk undertaken to achieve a given result.
- b) Promote sustainability of the company and include non-financial criteria that are geared towards creating long term value, such as compliance with rules and internal operating procedures and risk management and control policies.
- c) Are based upon balancing short-, medium- and long-term objectives, permitting the reward of continuous achievement over a period of time long enough to judge creation of sustainable value such that the benchmarks used for evaluation are not comprised of one-off, seldom occurring or extraordinary events.

Complies

59. That a material portion of variable remuneration components be deferred for a minimum period of time sufficient to verify that previously established performance criteria have been met.

Complies

60. That remuneration related to company results takes into account any reservations which may appear in the external auditor's report which would diminish said results.

Not applicable

61. That a material portion of variable remuneration for executive directors depends upon the delivery of shares or instruments indexed to share value.

Complies

62. That once shares or options or rights to shares arising from remuneration schemes have been delivered, directors are prohibited from transferring ownership of a number of shares

**equivalent to two times their annual fixed remuneration, and the director may not exercise options or rights until a term of at least three years has elapsed since they received said shares.**

**The forgoing shall not apply to shares which the director may need to sell in order to meet the costs related to their acquisition.**

#### Explain

On December 31, 2018, the Executive Director of the company, Mr. José María Álvarez-Pallete López held a shareholding at Telefónica, S.A., which amounted to 1,351,958 voting rights, which were valued with a price of 7.64 euros per share (according to its average value during 2018), represented 536% of his fixed remuneration. In this regard, it is noted that since his appointment as Executive Chairman, Mr. Álvarez-Pallete, as a demonstration of his commitment with Telefónica, has acquired a total of 798,704 shares.

Likewise, the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, held a shareholding at Telefónica, S.A., which amounted to 356,998 voting rights, which were valued with the same price per share, represented 170% of his fixed remuneration.

This shareholding owned demonstrate his commitment to Telefónica, and show that his own interests are aligned with the other shareholders' interests.

On the other hand, the Remuneration Policy for the Directors of Telefónica, S.A., approved by the Company's General Shareholders' Meeting on June 8, 2018, introduces, among others, the following novelties:

- It involves a new Long-Term Incentive Plan aimed at the Executive Directors, which establishes that at least 25% of the shares delivered derived from the Plan will be subject to a period of retention of no less than one year.
- Executive Directors must maintain (directly or indirectly) a number of shares (including those delivered as remuneration) equivalent to two annuities of their gross fixed remuneration, while they continue to remain on the Board of Directors and develop executive functions, establishing a five years period from the commencement of the Policy or, in the case of Executive Directors appointed thereafter, since their appointment, to achieve this objective.

**63. That contractual arrangements include a clause which permits the company to seek reimbursement of variable remuneration components in the event that payment does not coincide with performance criteria or when delivery was made based upon data later deemed to be inaccurate.**

#### 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. That payments made for contract termination shall not exceed an amount equivalent to two years of total annual remuneration and that it shall not be paid until the company has verified that the director has fulfilled all previously established criteria for payment.**

#### Explain

With regards to the conditions applicable to termination of contracts, the Executive Chairman, Mr. José María Álvarez-Pallete López, and the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, maintain the conditions of their previous contract which provided for agreed economic compensation for the termination of the employment relationship, where applicable, that can amount to four years' of remuneration at the most. Every annual payment includes the last fixed remuneration and the arithmetic average of the last two variable annual remuneration received according to contract.

## H. Further information of interest

**1. If there is any aspect regarding corporate governance in the company or other companies in the group that have not been included in other sections of this report, but which are necessary in order to obtain a more complete and comprehensible picture of the structure and governance practices in the company or group, describe them briefly below.**

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**2. This section may also be used to provide any other information, explanation or clarification relating to previous sections of the report, so long as it is relevant and not redundant.**

**Specifically, state whether the company is subject to any corporate governance legislation other than that prevailing in Spain and, if so, include any information required under this legislation that differs from the data requested in this report.**

**3. The company may also state whether it voluntarily complies with other ethical or best practice codes, whether international, sector-based, or other. In such a case, name the code in question and the date the company began following it. It should be specifically mentioned that the company adheres to the Code of Good Tax Practices of 20 July, 2010**

### - Note 1 to section A.2.]

On February 6, 2019, BlackRock, Inc. informed to the Securities Exchange Commission that its shareholding on the share capital of Telefónica, S.A. was 5.4%.

On February 1, 2019, BlackRock, Inc. informed to the Spanish National Securities Market Commission (CNMV) that, at January 31, 2019, its shareholding on the share capital of Telefónica, S.A. was 5.077%.

Likewise, and in accordance with the submitted communication by BlackRock, Inc. to the Spanish National Securities Market Commission (CNMV) on June 1, 2018, on June 20, 2018, on November 16, 2018, on January 23, 2019 and on February 1, 2019, the details of the control chain through this entity owns the voting right and/or the financial instruments is the following:

1.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc., BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd., Blackrock HK Holdco Limited, BlackRock Lux Finco S.a.r.l., BlackRock Japan Holdings GK, BlackRock Japan Co., Ltd.

2.- BlackRock, Inc, Trident Merger, LLC, BlackRock Investment Management, LLC.

3.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock Investment Management (UK) Limited.

4.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Australia Holdco Pty. Ltd., BlackRock Investment Management (Australia) Limited.

5.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock International Limited.

6.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Holdco 4, LLC, BlackRock Holdco 6, LLC, BlackRock Delaware Holdings Inc, BlackRock Institutional Trust Company, National Association.

7.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Holdco 4, LLC, BlackRock Holdco 6, LLC, BlackRock Delaware Holdings Inc., BlackRock Fund Advisors.

8.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc.

9.- BlackRock, Inc, BlackRock Holdco 2, Inc., BlackRock Financial Management, Inc., BlackRock International Holdings, Inc., BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd., BlackRock HK Holdco Limited, BlackRock Asset Management North Asia Limited.

10.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock Investment Management (UK) Limited, BlackRock Asset Management Deutschland AG.

11.- BlackRock, Inc, BlackRock Holdco 2, Inc., BlackRock Financial Management, Inc., BlackRock International Holdings, Inc., BR Jersey International Holdings, L.P., Blackrock Holdco 3, LLC, BlackRock Canada Holdings LP, BlackRock Canada Holdings ULC, BlackRock Asset Management Canada Limited.

12.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Capital Holdings, Inc, BlackRock Advisors, LLC.

13.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock Advisors (UK) Limited.

14.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd, BlackRock (Singapore) Limited.

15.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock (Netherlands) B.V.

**- Note 2 to Section A.3.]**

The General Shareholders' Meeting held on May 30, 2014 approved a long-term incentive plan intended for members of the Group's management team (including the Executive Directors), also known as the Performance & Investment Plan ("PIP").

The second cycle of that Plan began in 2015 and concluded in October 2018. In accordance with the provisions of its terms and conditions, the delivery of shares did not proceed for second cycle of the Plan (2015-2018), so no shares were delivered to the Executive Directors participating in this cycle.

As for the third cycle of this Plan (2016-2019), the Company's Board of Directors, following a favourable report from the Nominating, Compensation and Corporate Governance Committee, agreed not to execute nor implement the plan as it was not sufficiently aligned with the Telefónica Group's strategic plan, taking into account the circumstances and the macroeconomic situation.

On the other hand, the General Shareholders' Meeting held on June 8, 2018 approved a new Long-Term Incentive Plan ("Performance Share Plan - PSP"), consisting of the delivery of shares in Telefónica, S.A., aimed at Telefónica Group directors, including Telefónica Executive Directors who, complying with the requirements established for this purpose at any time, are invited to participate. The duration of the Plan will be five (5) years and will

be divided into three cycles (3) of three (3) years each (i.e., with delivery of the shares corresponding to each cycle after three years from the start of each cycle), independent among them. The first cycle began on January 1, 2018 (with delivery of the shares that correspond in 2021), the second cycle began January 1, 2019 (with delivery of the corresponding shares in 2022), and the third will begin January 1, 2020 (with delivery of the shares that correspond in 2023). In relation to the first cycle of this plan, taking into consideration the average weighted share price of Telefónica, S.A. in 30 trading days prior to January 1, 2018 and their respective fixed annual remuneration in force in 2018, with the maximum possible number of shares in the event of maximum compliance with the established objectives is to be received by Mr José María Álvarez-Pallete López, with 421,000 shares and, by Mr Ángel Vilá Boix, 312,000 shares. In relation to the second cycle of this plan, (whose shares were assigned in February 2019), taking into consideration the average weighted share price of Telefónica, S.A. in 30 trading days prior to January 1, 2019 and their respective fixed annual remuneration in force in 2019, with the maximum possible number of shares in the event of maximum compliance with the established objectives is to be received by Mr José María Álvarez-Pallete López, with 468,000 shares and, by Mr Ángel Vilá Boix, 347,000 shares.

### **-Note 3 to Section C.1.16.J**

#### **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 recognized caliber, 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.

With respect to this, the Board of Directors approved, at their meeting held on November 25, 2015, a Board Member Selection Policy. Likewise, on December 13, 2017, the Board of Directors approved an update of this Policy to include the Diversity Policy applicable to the Board of Directors. It was therefore renamed the Diversity Policy with respect to the Telefónica, S.A. Board of Directors and the Board Member Selection. It also includes the latest regulatory standards regarding diversity. The aim of this Policy is to ensure that the proposed appointment or re-election of Board Members is based on a preliminary analysis of the needs of the Board of Directors, and favors the diversity of knowledge, education and professional experience, age, and gender, but without implicit biases that could entail any discrimination, specifically based on gender, disability, or any other personal condition.

This Diversity Policy, with respect to the Telefónica, S.A. Board of Directors and Board Member Selection, is available on the corporate website of the Company.

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 organize 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 after 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 4 to Section C.2.1.J

The Audit and Control Committee of Telefónica, S.A. is regulated under article 39 of the corporate bylaws of the Company, and under article 22 of the Board of Directors regulations. Likewise, and in order to comply with the recommendations of Technical Guide 3/2017 of the Spanish National Securities Market Commission regarding Audit Committees of Public Interest Companies, the Board of Directors approved the regulations of the Audit and Control Committee of Telefónica, S.A. at their meeting held on December 13, 2017, which regulates the aforementioned Committee under 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 materialize; 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 authorization 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 individualized 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) Analyze 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 must have access to appropriate, opportune and enough information, for which:

- The Chairman of the Committee and, if it is considered opportune or is requested, the rest of its members, will maintain regular contact with the key personnel involved in the governance and management of the Company.
- The Chairman of the Committee, through the Secretary of the Committee, shall channel and provide the necessary information and documentation to the rest of the Committee Members, far enough in advance so that they can analyze it before their meetings.

The Audit and Control Committee, the Committee, shall meet at least once a quarter and whenever deemed necessary, with prior notice from their Chairman.

In any case, the Committee shall meet, at a minimum, when annual or intermediate financial information is published, and, in these cases, the meeting shall have the presence of the Internal Auditor and, if any kind of revision is issued, the Account Auditor.

Likewise, in the performance of its duties, the Committee may require the attendance of the Account Auditor, any employee or Company Manager, and the experts deemed necessary at its meetings.

Attendance at formal Committee meetings is preceded by the sufficient dedication of its members to analyze and evaluate the information received.

Likewise, the Committee has a secretary, who has the necessary attendance to plan meetings and agendas, for the drafting of the documents and minutes of the meetings, and for the collection and distribution of information, among other tasks.

In order to have an appropriate scheduling that makes it possible to ensure compliance with the effectively pursued objectives, the Committee establishes an Annual Work Plan.

The meetings are planned by the Chairman of the Committee, who notifies these meeting to the meeting secretary so that its members receive the documentation with enough notice. All of this keeping in mind that the Committee members have mainly supervisory and advisory duties, without intervening in the execution or management, as these are the duties of management.

Most important actions during the year and exercise of its duties.

The main activities and actions carried out by the Audit and Control Committee of the Telefónica, S.A. Board of Directors throughout 2018 have been related to the powers and duties that correspond to this Committee, either by legal requirements or from the interest that arises in each case with respect to the aforementioned powers. Therefore, the Audit and Control Committee has performed, among others, the following jobs:

- Regarding finances: i) revision of the financial information of the Company (Annual Account and Management Reports related to 2017, quarterly and semi-annual periodic financial information of Telefónica Group and the Public Interest Companies of the Group, for which this Committee has assumed the duties of the Audit Committee, and Alternative Performance Measurements, included in the Company Financial Information); ii) revision of the financial debt situation of Telefónica Group, and its development throughout the year; iii) revision of the informative brochures presented by the Company before the different supervisory bodies (among others, 20-F Annual Report and several informative brochures for financing operations, shares and debt); and iv) revision of monographic presentations on financial aspects and modifications to the accounting regulations. Likewise, the Committee has reviewed the non-financial and diversity information prepared by the Company in accordance with the current regulation.
- Regarding the external auditor: i) proposal of fees to be received by PwC as the Account Auditor for 2018; and ii) revision of the auditing works and limited revisions made by the external auditor with respect to the aforementioned financial information.
- Regarding internal control: i) revision of the works performed by Internal Auditing regarding the revision of transversal processes, investigations and inspections; and ii) revision of the risk management system.
- Regarding compliance, revision on regulatory compliance, including anti-corruption standards.
- Other relevant issues: i) 2017 Report of the Audit and Control Committee regarding related operations; ii) monthly Report of the Telefónica, S.A. Treasury Stock Management Team Supervisor regarding treasury stock operations; iii) review that the financial information published on the Company website is constantly updated and coincides with that which has been formulated, in each case, by the Board of Directors, and published on the CNMV website; and iv) periodic training to ensure the Committee members are updated on information.

Furthermore, regarding to the Directors of the Audit and Control Committee who have been appointed taking into account their knowledge and experience in accounting, audit or both, are Mr. José Javier Echenique Landiribar and Mr. Ignacio Moreno Martínez.

#### **-Note 5 to Section C.2.1.J**

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 shall be 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.

Most important actions during the year and exercise of its duties.

In the 4 meetings held by the Service Quality and Customer Service Committee in 2018, 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. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the Directors with the necessary documentation, so that it can take such actions into account when performing its duties.

**-Note 6 to Section C.2.1.J**

Subject to article 20.b) of the Board of Directors' Regulation, the Board has created the Strategy and Innovation Committee:

a) Composition.

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Strategy and Innovation Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the primary duty of the Strategy and Innovation Committee shall be:

- 1) To support the Board of Directors in the analysis and follow up of the global strategy policy of the Telefónica Group.
- 2) To advise and assist 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 important actions during the year and exercise of its duties.

The Strategy and Innovation Committee held 10 meetings in the 2018 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.

Likewise, 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. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the directors with the necessary documentation, so that it can take such actions into account when performing its duties.

**-Note 7 to Section C.2.1.J**

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 organize 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 important actions during the year and exercise of its duties.

The main activities and actions carried out by the the Nominating, Compensation and Corporate Governance Committee of the Telefónica, S.A. Board of Directors throughout 2018 have been linked to the powers and duties corresponding to this Committee, either by legal requirements or from the interest that arises in each case with respect to the aforementioned powers. Therefore, the Nominating, Compensation and Corporate Governance Committee has analyzed and reported on, among others, the following issues:

- The remuneration policy and system of the Telefónica Group Board Members and Management (fixed and variable remuneration, and action plans).

In particular, the Committee submitted to the Company's Board of Directors, for approval by the Ordinary General Shareholders' Meeting, the proposed remuneration policy for the Directors of Telefónica, S.A., for the three-year period 2019-2021. This remuneration policy was approved by the Company's General Shareholders' Meeting on June 8, 2018.

The main novelties introduced in the new Directors' remuneration policy, which maintains the basic outlines applied in the previous financial years, are as follows:

- Regarding the Annual Variable Remuneration, in the case of targets overachievement, it has been set a new maximum level of 233.10% of Fixed Remuneration (129.5% of the target annual variable remuneration) for the Executive Chairman and 194.25% of Fixed Remuneration (129.5% of the target annual variable remuneration) for the Chief Executive Officer.

- A new Long-Term Incentive Plan is introduced for the Executive Directors, among other members. This Plan features the following:

1. A maximum incentive limit for each cycle of the plan of 250% of the Annual Fixed Remuneration for the Executive Directors.
2. In addition to the economic-financial targets and targets related to creating value for shareholders, the possibility of setting targets linked to sustainability, the environment, society or good governance with a maximum overall weight of 10%.
3. At least the 25% of the shares that are awarded under the Plan will be subject to a retention period of one year.

- The Executive Directors must hold (directly or indirectly) a number of shares (including those awarded as remuneration) equivalent to two years' gross fixed remuneration for as long as they are members of the Board of Directors and perform executive duties.

- Proposals for appointments related to the Telefónica, S.A. Board of Directors and its Committees, and with the Boards of subsidiary companies

To this respect, the Nominating, Compensation and Corporate Governance Committee proposed and/or reported, as applicable, the appointment of Telefónica, S.A. Board Members in 2018, addressing

the solvency, competency, experience, professional merits and availability of the candidates to dedicate the necessary time and effort for the effective performance their duties, exclusively considering their individual and professional characteristics.

Thus, in its meeting held on January 30, 2018 the Committee favourably informed the appointment by co-option as Proprietary Director, and at the proposal of CaixaBank, S.A., of Mr. Jordi Gual Solé, after the voluntary resignation from its position as Board Member presented by Mr. Antonio Massanell Lavilla. Likewise, at the aforementioned meeting on January 30, 2018, the Committee favourably informed the appointment of the Proprietary Director Mr. Jordi Gual Solé as Member of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee.

Furthermore, at its meeting held on April 24, 2018, the Committee proposed to the Company's Board of Directors the appointment by co-option of Ms. María Luisa García Blanco, after the voluntary resignation from their positions as Board Members, presented by Ms. Eva Castillo Sanz.

Likewise, at its meeting held on May 29, 2018, the Committee proposed the appointment of the Independent Director Ms. María Luisa García Blanco as Member of the Service Quality and Customer Service Committee, and of the Regulation and Institutional Affairs Committee. Likewise, at the aforementioned meeting on May 29, 2018, the Committee proposed the appointment of the Independent Director Mr. Peter Löscher as Member of the Service Quality and Customer Service Committee.

Additionally, the Committee favorably informed and/or proposed, as the case may be, the re-election and ratification of Telefónica, S.A. board members by the Company General Shareholder's Meeting held on June 8, 2018, after having taken into consideration and evaluated the duties performed and the dedication given by the aforementioned Board Members during his/her year of duty, basing the entirety of the proposals on a preliminary analysis of the needs of the Board of Directors, whose purpose is to favor the diversity of knowledge, experiences and gender.

Thus, the aforementioned Ordinary General Shareholders' Meeting approved, at the proposal of the Company's Board of Directors, the re-election of Mr. Luiz Fernando Furlán, Mr. Francisco Javier de Paz Mancho, and Mr. José María Abril Pérez, as well as the ratification of the appointment by co-option of Mr. Ángel Vilá Boix, Mr. Jordi Gual Solé, and Ms. María Luisa García Blanco.

- Proposals for the appointment of Board Members at the subsidiary companies of the Telefónica Group.
- Appointment proposals related with the Senior Management and the organizational structure of the Telefónica Group.
- Corporate Governance Report and Remuneration Report 2017.

#### **-Note 8 to Section C.2.1.J**

Subject to article 20.b) of the Board of Directors' Regulation, the Board has created the Regulation and Institutional Affairs Committee:

##### a) Composition.

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Regulation and Institutional Affairs Committee shall be appointed from among its members.

##### b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the Regulation and Institutional Affairs Committee shall have, at least, the following duties:

- 1) To carry out, through study, analysis and discussion, permanent monitoring of the main matters and themes of the regulatory order that affect the Telefónica Group at all times.
- 2) To provide a channel for communication and information between the management team and the Board of Directors in statutory matters and, when appropriate, to bring to the knowledge of the latter matters that are considered relevant to the Company, or to any of the companies in the Group and on which it may be necessary or convenient to adopt a decision or to establish a specific strategy.
- 3) To review, report and propose to the Board of Directors the principles that must guide the Group's Sponsorship and Patronage policy, monitor such policy and individually approve all sponsorships or patronages that exceed the limit set by the Board, and that have to be approved by the Board.
- 4) To promote the development of the Telefónica Group's Corporate Reputation and Responsibility project and the implementation of the core values of such Group.

The Reputation and Corporate Responsibility strategy is implemented through the Global Responsible Business Plan. This plan includes objectives in aspects such as: ethical behavior, human rights, customer promise, environment, climate change, supply chain, digital trust, talent and diversity, and sustainable innovation, as well as other topics that are identified as risks or opportunities for the company in relation to sustainability. The Commission is also pursuing recurrent issues such as reputation metrics and sustainability and reputation risk mapping.

#### Most important actions during the year and exercise of its duties.

The Regulation and Institutional Affairs Committee held 11 meetings in the 2018 year, have been analysed and debated:

- The regulatory matters of most significance for the Telefónica Group, 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 aforementioned Regulatory Agenda, are updated in each meeting, and in the specific documents or reports submitted to the Committee, when deemed advisable.
- A 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 of Sustainability (ethical behavior, sustainable innovation, digital confidence, supply chain, talent and diversity management, customer, environment and climate change), including Responsible Business Plans, and Integrated Annual Report.
- The most relevant institutional milestones of the Telefónica Group with regard to the Company's Institutional Relations.

As with the other Board Committees, the relations between this Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the Directors with the necessary documentation, so that it can take such actions into account when performing its duties.

#### **-Note 9 to Section C.2.1.J**

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 (where, in the case of the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee, the Operating Report is named), 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.

**-Note 10 to Section C.2.1.J**

Mr. Ángel Vilá Boix is the Chief Operating Officer (C.O.O.).

**-Note 11 to Section D.6.J**

Company policy establishes the following principles governing possible conflicts of interest that may affect Directors, senior executives or significant shareholders:

- 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.

- 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 favorable 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 fulfill the three following requirements:

- 1.º they are performed by virtue of contracts whose conditions are standardized and are applied on an across-the-board basis to a large number of clients,
- 2.º they are performed at prices or tariffs generally set by the person supplying the goods or services, and
- 3.º 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.

- 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 that established in this regulation, the people with management responsibilities, their administrative personnel and the managers or employees of Telefónica Group who have privileged information, or participate or have access to or knowledge of a confidential operation (as defined in the previous terms of the internal conduct regulations regarding Stock Markets) have the obligation to (a) remain loyal to the Group and its shareholders at all times, regardless of his/her own or other's interests; (b) refrain from intervening in or influencing decision making that could affect persons or companies with which there is conflict; and (c) refrain from accessing information classified as confidential that affects said conflict. Additionally, these people (except for the members of the Company Board of Directors who will be governed in terms of communicating conflicts under the standards established in the regulation of the Board of Directors) have the obligation to make the Company Regulatory Compliance Unit aware of these operations that would potentially entail the manifestation of conflicts of interest.

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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 other international regulations and initiatives in the area of sustainability as well as, among others, 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 20, 2019.**

**List whether any directors voted against or abstained from voting on the approval of this report.**

No

**APPENDIX TO THE TELEFÓNICA, S.A. 2018 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 affected 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 Telefónica which could affect its business, financial position, reputation, corporate image and brand and its results of operations are set out below and must be considered jointly with the information set out in the Consolidated Financial Statements:

**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 diverse legislation, as well as to the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in this regard, including exchange-rate or sovereign-risk fluctuations, may adversely affect Telefónica's business, financial position, cash flows and results of operations 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.

In Europe, the macro-financial outlook showed a slight deterioration during the second half of 2018, influenced by external factors such as the weaker and maturing global economic cycle, the recent tightening of financial conditions, the greater uncertainty associated with the trade tensions between China and the United States and the risks that such tensions pose on economic growth and global stability. On the regional front, the political uncertainty in Europe has diminished in part after the results of the general elections in some European countries, but it still persists in various countries, including Italy, given the lack of political commitment with a reformist agenda. Economic activity and financial stability in Europe could also be affected by the monetary normalization that the European Central Bank is expected to continue implementing and by how Greece continues to manage its ongoing banking and economic restructuring process, after the country's recent exit from its bailout program.

Furthermore, the planned exit of the United Kingdom from the European Union ("EU") following the outcome of the referendum held in June 2016 is expected to result in economic adjustments regardless of the nature of the new trade and investment relationships between the United Kingdom and the rest of Europe in the future. As of the date of this Annual Report, there is significant uncertainty regarding the Brexit negotiations and required parliamentary approvals, both in terms of timing (the process can be subject to delays) and the final outcome, with multiple options still being possible, including a no deal Brexit. In the meantime, uncertainty surrounding Brexit could have a negative impact on investment, economic activity and employment. It could also lead to financial market volatility, which could limit or restrict access to capital markets. This situation could worsen depending on the final terms of Brexit, which could increase regulatory and legal complexities, including those relating to tax, trade and security. Such changes could be costly and potentially disruptive to business relationships in these markets, including those of Telefónica, its suppliers and its customers. The elections to the European Parliament in May 2019 could also lead to political uncertainty, as they could result in a rebalancing of political groupings and significant changes in goals for the European project in the medium term, as well as in changes in key positions of the main European institutions during 2019.

In Spain, another possible source of uncertainty is Catalonia's political situation and its impact on the Spanish economy. Although recent developments have contributed to reduce such uncertainty, if political tensions re-emerge or intensify, there could be a negative impact both on financing conditions and on the Spanish macroeconomic scenario, given the demanding sovereign bond maturity calendar and the high dependence of the Spanish economy on the international investors and economic outlook. There is also some uncertainty regarding the economic policy mix to be implemented in 2019 as a result of the current high parliamentary fragmentation. In 2018, the Telefónica Group obtained 26.1% of its revenues in Spain (24.3% in 2017), 15.0% in Germany (14.0% in 2017) and 13.9% in the United Kingdom (12.6% in 2017).

In Latin America, exchange rate risk is particularly noteworthy. Certain external factors contributing to this risk are the uncertainty derived from the monetary normalization process in the United States, increasing global trade tensions, the continuing low commodity prices in certain cases and doubts about growth and financial imbalances in China. Certain internal factors contributing to this risk are the high fiscal and external deficits in major Latin American countries and the low liquidity in certain exchange markets, together with low productivity growth, which hinder a more accelerated progress in economic development and the rebalancing of still existing mismatches.

In Argentina, the government is focused on resolving the country's macroeconomic and financial imbalances and on recovering international confidence, particularly after the agreement reached with the International Monetary Fund to provide financial support in the medium term. Even though the measures taken by the government are expected to have positive effects in the medium term, both the macroeconomic and exchange rate risks remain high in the short term. The major challenges the economy is facing, both internally (with an ongoing sharp reduction of public deficit in an environment of economic recession and high inflation) and externally (with significant financing needs in the medium term), make the Argentine economy vulnerable to episodes of volatility in the financial markets. Moreover, the presidential elections due to take place in 2019 pose additional risks, as they could result in a change in the current economic policy stance with very limited economic policy levers.

In Brazil, after the presidential elections resulted in a change of government, the effectiveness of such government in implementing the announced and needed reforms that would improve the potential growth of the economy and drive the fiscal accounts towards sustainability remains to be seen. On the other hand, while signs of stabilization have emerged and the economy has started to show positive growth figures, the pace of the recovery is still gradual. Despite the decreasing external financing needs, internal financing needs remain high, and financing conditions remain challenging, as the country sovereign credit rating remains below investment grade.

Mexico has a high commercial and financial exposure to the United States, which could generate uncertainty. Domestically, there is also uncertainty surrounding the new government's political agenda, despite having a relatively stable economic outlook. Both the political management by the new government of the structural achievements made in recent years and the final approval of the Agreement between the United States, Mexico and Canada (USMCA) are expected to have a material impact on the economy. While the signing of USMCA has significantly reduced uncertainty, it has not eliminated it, as the agreement still needs to be ratified by the respective national legislative chambers. Any higher than expected increase in interest rates in the United States and/or a possible re-negotiation of trade agreements between the abovementioned countries could result in higher restrictions on imports into the United States, which, together with political uncertainty surrounding such matters, could negatively impact economic activity and exchange rates in Mexico. The relative weight of Mexico in the consolidated revenues of the Telefónica Group was 2.4% in 2018.

Chile, Colombia and Peru have been able to stabilize their economies with growth rates close to their potential growth led by domestic demand, while recent adjustments and political decisions have addressed certain fiscal and external account issues. Nevertheless, these economies are exposed not only to changes in the global economy given their vulnerability to abrupt movements in commodity prices, but also to unexpected changes in financial conditions.

In Ecuador, a decrease in domestic political uncertainty has allowed for an improvement in economic activity through exports, but risks persist, mainly on the fiscal front. The country's financing needs are still high, which, together with low international reserves, keep the country in a vulnerable position against volatility shocks.

In 2018, Telefónica Brazil represented 20.8% of the Telefónica Group's revenues (23.1% in 2017). In 2018, Telefónica Hispam Norte and Telefónica Hispam Sur represented 8.4% and 13.7% of the Telefónica Group's revenues, respectively (8.3% and 15.8%, respectively, in 2017). In 2018, 4.3% of Telefónica Group's revenues came from Chile, 4.3% from Peru and 4.8% from Argentina. In 2018, 28.2% of the Group's revenues were generated in countries that do not have investment grade status (in order of their contribution to the Group's

revenues: Brazil, Argentina, Ecuador, Costa Rica, Nicaragua, Guatemala, El Salvador and Venezuela) and other countries are only one notch away from losing this status.

"Country risk" factors include, among others, the following:

- 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;
- high inflation rates;
- expropriation or nationalization of assets, adverse tax decisions, or other forms of state intervention;
- economic and 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 is 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/or 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 or interest rates.**

In nominal terms, as of December 31, 2018, 73.6% of the Group's net financial debt plus commitments was pegged to fixed interest rates for a period greater than one year. As of the same date, 18.7% of the Group's net financial debt plus commitments was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to variations in short-term interest rates as of December 31, 2018: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica had a financial position at that date would have led to an increase in financial expenses of 102 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies (even if negative rates are reached), would have led to a reduction in financial expenses of 88 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and taking into account the derivative financial instruments arranged by the Group.

According to the Group's calculations, the impact on results and specifically on net exchange differences due to 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 1 million euros for the year ended December 31, 2018, primarily due to the weakening of the Venezuelan bolivar and, to a lesser extent, the Argentine peso. These calculations have been made assuming a constant currency position with an impact on profit or loss as of December 31, 2018, taking into account derivative instruments in place.

During 2018, Telefónica Brazil represented 27.7% (25.9% in 2017), Telefónica United Kingdom represented 12.0% (10.1% in 2017), Telefónica Hispam Norte represented 5.1% (7.8% in 2017) and Telefónica Hispam Sur represented 11.0% (14.1% in 2017) of the operating income before depreciation and amortization ("**OIBDA**") of the Telefónica Group.

The Telefónica Group uses a variety of strategies to manage this risk, among others the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. However, 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/or cash flows.

The evolution of exchange rates negatively impacted the Group's 2018 results, decreasing the year-on-year growth of the Group's consolidated revenues and OIBDA by an estimated 8.8 percentage points and 10.3

percentage points, respectively, mainly due to the depreciation of the Brazilian real and the Argentine peso (3.2 percentage points and 4.7 percentage points, respectively in 2017, mainly due to the depreciation of the Argentine peso, the Venezuelan Bolivar and the pound sterling) . Furthermore, translation differences had a negative impact on the Group's equity of 2,043 million euros as of December 31, 2018, whereas they had a negative impact on the Group's equity of 4,279 million euros as of December 31, 2017.

If the Group does not effectively manage its exposure to foreign currency exchange rates or interest rates, it may adversely affect its business, financial position, results of operations and/or 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 operation, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the 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 Telefónica, or 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 and/or cash flows.

Funding could be more difficult and costly in the event of a deterioration of conditions in the international or local financial markets due, for example, to monetary policies set by central banks, including increases in interest rates and/or balance sheet reductions, increasing global political and commercial uncertainty and oil price instability, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

As of December 31, 2018, the Group's net financial debt amounted to 41,785 million euros (44,230 million euros as of December 31, 2017) and the Group's gross financial debt amounted to 54,702 million euros (55,746 million euros as of December 31, 2017). As of December 31, 2018, the average maturity of the debt was 8.98 years (8.08 years as of December 31, 2017).

As of December 31, 2018, the Group's gross financial debt scheduled to mature in 2019 amounted to 9,368 million euros and gross financial debt scheduled to mature in 2020 amounted to 6,417 million euros.

In accordance with its liquidity policy, Telefónica has covered its gross debt maturities for the next 12 months with cash and credit lines available at December 31, 2018. As of December 31, 2018, the Telefónica Group had undrawn committed credit facilities arranged with banks for an amount of 12,219 million euros (11,887 million euros of which were due to expire in more than 12 months). Telefónica's liquidity could be affected if market conditions make it difficult to renew existing undrawn credit lines. As of December 31, 2018, 2.7% of the aggregate undrawn amount under credit lines was scheduled to expire prior to December 31, 2019.

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 Telefónica's financing and its liquidity strategy. This in turn could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

**Adoption of new accounting standards could affect the Group's reported results and financial position.**

Accounting standard-setting bodies and other authorities may periodically change accounting regulations that govern the preparation of the Group's consolidated financial statements. Those changes could have a significant impact on the way the Group accounts for certain matters and presents its financial position and its results of operations. In some instances, a modified standard or a new requirement with retroactive effect must be implemented, which requires the Group to restate previous financial statements.

In particular, Telefónica is required to adopt the new accounting standard IFRS 16 Leases ("IFRS 16") effective from January 1, 2019.

This standard requires significant changes that will affect the accounting treatment for all lease contracts where Telefónica acts as lessee, other than certain short-term leases and leases of low-value assets. The Group estimates that the first-time adoption of IFRS 16 will have a material impact on the Group's financial statements and may make comparisons between periods less meaningful. It will also likely materially affect the amounts used to calculate certain financial metrics reported by the Group or used by analysts and investors to analyze the Group.

Note 3 to the Consolidated Financial Statements includes information on the main impacts expected from the first-time adoption of the new requirements.

**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 sector-specific regulations in the majority of the countries where the Group operates. 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 the acquisition of spectrum capacity. Among the main legal risks 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. The fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations.

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 provision of services in a specific market. The spectrum to which most of the licenses and administrative concessions refer to is used for the provision of mobile services on 2G, 3G and 4G technologies. The complementarity between the different frequency bands successively assigned to an operator in a geographic market enables greater flexibility and efficiency in both the deployment of the network and the provision of services to final customers over the capacities resulting from such network.

Any challenges or amendments to the terms of licenses, authorizations or concessions granted to the Group and necessary for the provision of its services or the Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed below 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 its ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and/or cash flows.

Additional information on the key regulatory issues and concessions and licenses held by the Telefónica Group can be found in Appendix VI of the Consolidated Financial Statements.

Additionally, the Telefónica Group could be affected by regulatory actions of the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or impose heavy fines. Any such measures implemented by the antitrust 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.

*Regulation of spectrum and access to new government licenses/concessions of spectrum*

In Europe, the Directive (EU) 2018/1972 of the European Parliament and of the Council establishing the European Electronic Communications Code ("EECC"), was approved on December 11, 2018. The aim of the EECC is fostering investment in new high-capacity networks (principally fiber networks and the fifth generation of mobile telecommunications, or 5G) and create a 'level playing field' between telecommunications companies and over-the-top providers ("OTTs"). Member States have a period of two years (until December 21, 2020) to transpose said Directive into their national legislation. Certain provisions included in the EECC are so extensive and complex that their final impact on operators, such as Telefónica, will largely depend on how they are interpreted by regulatory authorities in each Member State. The EECC will continue to oblige national regulatory

authorities to analyze telecommunications markets and determine whether any operators dominate the market. Such operators will continue to be designated as having significant market power ("SMP") and face additional obligations in that territory. In the case of new fiber networks, such SMP obligations could be relaxed if co-investment agreements bear fruit among SMP and non-SMP networks operators.

Furthermore, in Europe, spectrum auctions are expected to take place in the coming years, requiring potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with some of these licenses.

In Spain, the auction of the 3.6 GHz band was carried out during July 2018, and Telefónica was awarded 50 MHz. The Ministry of Economy and Business Affairs has published the roadmap to clear spectrum in the 700 MHz band from its current use (digital television), in line with the calendar approved by the European Commission ("EC") and with the 5G National Plan adopted in December 2017. The plan foresees the completion of the release of the 700 MHz band before June 30, 2020 and the Ministry has indicated its intention to hold the auction in 2020.

In the United Kingdom, the Office of Communications ("Ofcom"), the national telecommunications regulatory authority, conducted a spectrum auction for the 2.3 GHz and 3.4 GHz bands in March and April 2018. Telefónica United Kingdom won all of the 2.3 GHz spectrum available (40 MHz) and an additional 40 MHz of the 3.4 GHz spectrum band (out of the 150 MHz available), in both cases under 20-year renewable licenses. In December 2018, Ofcom launched a public consultation regarding the coverage obligations and auction design relating to the 700 MHz/3.6GHz bands, which are expected to be auctioned in the first quarter of 2020.

In Germany, on May 14, 2018 the Regulatory Agency for Electricity, Gas, Telecommunications, Post and Railway ("BNetzA") published Decisions I and II on the method to award frequencies nationwide, in the 2GHz band and a large part of the 3.6 GHz band. In addition, under the same decisions, BNetzA allocated 100 MHz in the 3.6 GHz band and also frequencies in the 26 GHz band, both for local/regional assignments upon application.

Subsequently, on November 26, 2018, BNetzA published Decisions III and IV establishing the conditions for frequency usage and auction rules on the above-mentioned 2 GHz and 3.6 GHz bands (Auction Rules). The rules include obligations for better coverage in both urban and rural areas, as well as along transport routes and other conditions, such as the obligation to negotiate on national roaming and network sharing. The above four decisions have been challenged in Court by Telefónica Deutschland Group. Nevertheless, Telefónica Deutschland Group submitted its application to the auction by January 25, 2019. The auction is scheduled to begin in the first quarter of 2019.

All of the bands mentioned above are considered to be technologically neutral, which means that they could potentially be used in the future for 5G services.

In Latin America, spectrum auctions are expected to take place in the coming years, potentially requiring cash outflows to obtain additional spectrum or to meet the coverage requirements or other obligations associated with these licenses. Specifically, the procedures that will take place in 2019 in jurisdictions that are relevant for the Group are:

- Argentina: the government issued on January 21, 2018 a decree (Decreto de Necesidad y Urgencia) that contemplates the possibility of auctioning the spectrum previously reserved for ARSAT (a public company). The spectrum that was reserved for ARSAT includes 20 MHz in the 700 MHz band (national), 50 MHz in the AWS band (national) and 20 MHz in the 1900 MHz band (regional).
- Brazil: In September 2018, the Brazilian regulator, Anatel, launched a first consultation to award spectrum in the 2.3GHz TDD (time-division duplexing) band and spectrum in the 3.5GHz TDD band. A consultation on the auction of the remaining spectrum in the 700 MHz band is expected to take place in the first half of 2019. Anatel's 5G commission has also identified 1500 MHz which could be auctioned. An auction to award spectrum in any of these bands could take place in 2019 or 2020.



- Colombia: The consultation processes launched in 2017 and early 2018 on the conditions of the 700 MHz spectrum auction were suspended following the change of government that took place in August 2018. The new government has submitted to Congress a draft bill with regards to information and communication technologies. Among the measures included in the draft bill, there is an extension of the duration of spectrum licenses. The approval process of the draft bill may have an impact on the timing of the auction. This draft bill is expected to be discussed in the first quarter of 2019.
- Peru: In October 2018, the Ministry of Transport and Communications approved a new regulation for the reorganization of frequency bands, known as "refarming". This could result in a spectrum award process in 2019 or 2020.

It is possible that some of the abovementioned spectrum tender procedures will not be completed, or even initiated within the proposed time frames. In addition, in the cases where Telefónica has submitted comments to the proposed conditions of auctions or allocation procedures, there is no certainty as to whether and to what extent such comments will be considered by the relevant regulator. In addition, Telefónica may decide to abstain from a particular process once it reviews the viability of each spectrum acquisition opportunity.

In addition to the spectrum tender procedures referred to above, it may be the case that certain administrations which have not yet announced their intention to release new spectrum may do so during 2019 and thereafter. The above does not include processes announced through general statements by administrations, which involve bands not key to Telefónica's needs. Furthermore, Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

#### *Risks relating to concessions and licenses previously granted*

In Spain, pursuant to the license for the 800 MHz spectrum band, there are a series of obligations that Telefónica is subject to with the aim of reaching coverage that allows access, with a speed of at least 30 Mb per second, to at least 90% of the inhabitants in population units of less than 5,000 inhabitants. The approval of the final terms and conditions to implement this coverage obligation was published in November 2018. Telefónica is undergoing a constant process of deployment and densification of Long Term Evolution ("LTE") solutions over the 800 MHz band that will be the base for compliance with such obligation.

Telefónica owns two concessions in the 2.1 GHz and 3.5 GHz spectrum, both awarded in 2000, which expire in April 2020 but may be extended for an additional ten years.

In the state of São Paulo, Telefónica Brazil provides local and national long-distance Fixed Switched Telephony Services ("STFC") under the so-called public regime, through a concession agreement, which is expected to remain in force until 2025. At December 31, 2018, the estimated residual value of the assets assigned to the provision of STFC was 8,622 million Brazilian reais (approximately 1,943 million euros under the exchange rate applicable on such date) (8,763 million Brazilian reais as of December 31, 2017, approximately 2,209 million euros under the exchange rate applicable on such date), which comprised switching and transmission equipment and public use terminals, external network equipment, energy, system and operational support equipment. In principle, such assets were considered to be reversible assets, and were thus supposed to revert to the federal government at the end of the concession agreement. However, the implementation of a bill amending the regulatory framework in Brazil which establishes, among other things, that such assets would no longer be reversible under a new license regime in exchange for investment commitments, is currently pending. The bill was approved at both legislative houses, but was challenged before the Federal Supreme Court due to an alleged procedural defect. The outcome of this lawsuit is uncertain, although the Senate's board may overcome it by sending the bill for voting in the Plenary. In the event that the bill is finally approved, ANATEL would be entitled to adopt the relevant administrative decisions for the amendment of the respective licenses with the consequent amendment of the future obligations imposed on STFC providers.

As of the date of this Annual Report, there is no certainty that the proposed change in the regulatory framework will be completed, or that it will be completed in fully satisfactory terms for Telefónica Brazil. Only after this bill or a similar law is adopted (enabling the exchange of reversion obligations for investment commitments) could ANATEL impose the investment obligations referred to above.

As of the date of this Annual Report, it is not possible to estimate the hypothetical investment obligations that ANATEL could impose on the concessionaires, including Telefónica Brazil, in exchange for eliminating their obligation to revert assets used for the provision of the STFC services.

In Colombia, the ITC issued resolution 597 on March 27, 2014 to renew 850 MHz/1900 MHz band licenses for ten additional years. Under the scope of such resolution, Colombia Telecomunicaciones, S.A. ("**ColTel**") (67.5% of which is owned, directly and indirectly, by Telefónica and 32.5% of which is owned by the government of Colombia), renewed its license to exploit such spectrum to provide telecommunication services.

The concession agreements from 1994, which were renewed in 2004 and under which the mobile telephone services were provided until November 28, 2013, contained a reversion clause for the underlying assets. However, Law 422 of 1998 and Law 1341 of 2009 provided that upon expiration of a concession agreement for telecommunication services, only the spectrum reverts to the State. That was the understanding under which all the operators, including the authorities, operated between 1998 and 2013. In 2013, however, when analyzing an appeal on the constitutionality of said laws, the Constitutional Court confirmed the constitutionality of the laws but ruled that it could not be concluded that those laws modified with retroactive effect the reversion clause of the concession agreements of 1994. On February 16, 2016, the ITC started an arbitration proceeding against ColTel and other defendants in accordance with the terms of the relevant concession agreement of 1994, in order to clarify the validity and scope of such reversion clause. The arbitration award was rendered on July 25, 2017 and was not favorable to ColTel and its co-defendants.

The arbitration tribunal ordered ColTel to pay 1,651,012 million Colombian pesos. On August 29, 2017, the shareholders' meeting of ColTel approved a capital increase in a total amount of 1,651,012 million Colombian pesos (470 million euros at the exchange rate as of such date) to pay the amount imposed by the arbitration award. The Telefónica Group and the Colombian government subscribed the capital increase pro rata to their respective shareholding in ColTel. Telefónica's decision to participate in the capital increase does not constitute, and should not be understood as, an acceptance of the arbitration award. Telefónica reserves all of its legal rights and the exercise by Telefónica or ColTel of any applicable legal action, national or international. Both ColTel and Telefónica have started legal actions. On August 18, 2017, ColTel filed an appeal to challenge the arbitration award at Colombia's highest court of administrative litigation (Consejo de Estado), which was dismissed on May 24, 2018. In addition, on December 18, 2017, ColTel also filed a constitutional action (acción de tutela) with the Constitutional Court seeking to protect its constitutional rights, jeopardized by the arbitration award. On March 15, 2018, the constitutional action was denied and ColTel filed an appeal against this ruling on April 18, 2018, which was dismissed on May 24, 2018. On November 27, 2018 a recusal motion was filed at the Constitutional Court, which is pending resolution.

In addition, pursuant to the relevant bilateral treaty, Telefónica notified Colombia of its intention to file a claim in the International Center for Settlement of Investment Disputes ("**ICSID**"). After the expiration of the required 90-day notice period, on February 1, 2018, Telefónica submitted the arbitration request to the ICSID and, on February 20, 2018, the General Secretary of ICSID registered the request for the institution of arbitration proceedings. The request for arbitration is ongoing and the arbitral tribunal is in the process of being appointed.

In Peru, Telefónica has concessions for the provision of fixed-line services until November 2027. In December 2013, Telefónica filed a partial renewal request for these concessions for five more years. On November 26, 2018, the Ministry of Transportation and Communications (Ministerio de Transportes y Comunicaciones) notified the denial of such renewals. Telefónica has filed an appeal for reconsideration. On February 5, 2019 the Ministry dismissed the mentioned appeal and Telefónica is considering to challenge the decision. In December 2014, June 2016 and May 2017 Telefónica filed renewal requests for an additional 20 years in relation to a concession for the provision of local carrier services, one of the concessions to provide mobile services in certain provinces, and one concession to provide fixed-line services, respectively. In addition, in April 2016, Telefónica filed a renewal request in relation to the 1900 MHz frequency spectrum for the Provincias (all of Peru except for Lima and Callao), which license expired in 2018.

As of the date of this Annual Report, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) in these proceedings is still pending and, according to the legislation, the underlying concessions remain in force as long as the proceedings are pending.

In Chile, Telefónica Móviles Chile, S.A. and other two telecommunications operators were awarded spectrum in the 700 MHz band in March 2014, with Telefónica Móviles Chile being awarded 2x10 MHz. While services are being provided on such spectrum, a consumer organization filed a claim before the Tribunal for the Defense of Free Competition (the "TDFC") against Telefónica Móviles Chile, S.A. and the other two operators, regarding the allocation of spectrum in the 700 MHz band and challenging the outcome of the spectrum allocation. The TDFC rejected this claim on consecutive occasions but, on June 25, 2018, the Supreme Court issued a final judgment stating that the assignment of spectrum in the 700 MHz band to the mobile operators constituted anticompetitive behavior as it awarded spectrum blocks without respecting the 60 MHz spectrum cap set by the Supreme Court in a ruling from 2009.

The Supreme Court ruled that the incumbent operators have to relinquish the same amount of spectrum that they acquired in the 700 MHz band auction. However, the ruling of the Supreme Court allows the operators to choose the band from which the spectrum that exceeds the fixed cap (60 MHz) is to be relinquished and no deadline has been set to complete such relinquishment. As of the date of this Annual Report, Telefónica Móviles Chile has not relinquished any of the required spectrum, since the proceeding has been temporarily suspended by a resolution issued by the Constitutional Court on January 29, 2019.

The Supreme Court ruling also states that if the sector-specific authority ("**Subtel**") considers it necessary to review the maximum spectrum cap, it should put in place a consultation process before the TDFC. Subtel must otherwise initiate the necessary procedures to adapt the set cap to the fixed parameters of 60 MHz for each participating operator in the aforementioned radio spectrum. On October 3, 2018, Subtel submitted its proposal on the review of the maximum spectrum cap to the TDFC.

Additionally, Subtel submitted to the TDFC a proposal of "complementary conditions" with a general scope which would be applicable to all bands, as well as another proposal of "special conditions" to be considered in future auctions. The TDFC set a deadline of December 28, 2018 for interested parties to provide their comments. The process initiated by the TDFC is expected to last several months.

In addition, the Supreme Court rejected the appeal filed by Telefónica Móviles Chile, S.A. against the resolution of the TDFC that ordered immediate compliance with the spectrum relinquishment obligations, without waiting for the result of the spectrum cap consultation. However, on January 29, 2019, the Constitutional Court temporarily suspended the obligation to immediately comply with such spectrum relinquishment obligations until the remedy of inapplicability that has been filed by Telefónica is resolved.

Additionally, regarding the 3.5 GHz band, Subtel issued a decision on June 21, 2018 regarding the 3.4-3.8 GHz spectrum band, which, among other things, has suspended the granting of authorizations, the modification of concessions and the reception of network rollouts in connection with this spectrum band. Its purpose is to carry out an in-depth study on the efficiency of the usage of this band for 5G and ensuring the efficient usage of this band in light of international best practices and the need for efficient spectrum management. The decision had a limited impact on Telefónica's operations as Telefónica Chile, S.A. only has 50 MHz of spectrum assigned in that band in Regions XI and XII (representing less than 2% of the population) and that spectrum is currently not in use. On October 3, 2018, Subtel modified the above mentioned resolution and resolved to release part of this spectrum to enable operators to provide wireless fixed services. Of the 50 MHz awarded to Telefónica Chile, S.A., 30 MHz were released and may only be used for mobile services, which is a required change for 5G provision, once future auctions on 3400-3800 MHz range are firmly awarded. The remainder of the spectrum may not currently be used for any service.

On November 20, 2018, Telefónica Chile, S.A. requested the TDFC to initiate a consultation process to determine whether the decision of Subtel regarding the 3.5 GHz band violates competition law. The deadline for third parties to provide background information expired on February 18, 2019.

In Mexico, in August 2018, Telefónica participated in the auction of the 2500-2690 MHz band and was awarded 2x20 MHz of spectrum. The rules and the procedure of the auction were challenged by an operator and Telefónica has responded to the allegations made. Telefónica's regional holdings in the 1900 MHz band (approximately 44% of the total 1900 MHz band) expired in October 2018. Telefónica has requested the renewal of this concession. The Instituto Federal de Telecomunicaciones ("IFT") is expected to decide on the renewal request during the first quarter of 2019. Telefónica may continue to use this spectrum while the IFT decision is pending.

In 2018, the Group's consolidated investment in spectrum acquisitions and renewals amounted to 868 million euros (538 million euros in 2017).

#### *Regulation of wholesale services*

The EC's proposal in respect of the regulatory framework for wholesale services intends, among other measures, to incorporate a costing methodology to fix a European upper limit for the call-termination prices for landline phones/mobile phones (FTRs/MTRs) applicable in the EU. According to this proposal, the decreases in wholesale mobile termination rates ("**MTRs**") in Europe have been noteworthy. It should be noted that since termination fees in mobile and fixed communications have decreased substantially in recent years, future decreases are expected to become smaller so that the negative impact on turnover is expected to be less significant than in the past.

In the United Kingdom, on June 1, 2018, the price of MTRs fell to 0.489 pence per minute. From April 1, 2019, they will be priced at 0.479 pence per minute, with a further reduction based on inflation (consumer prices index ("CPI") minus 3.7% from April 1, 2020).

In Spain, in January 2018 the Spanish National Regulatory and Competition Authority (Comisión Nacional de los Mercados y la Competencia or "**CNMC**") approved a decision setting the new MTRs for all mobile operators, which will result in a progressive reduction of 40% from January 2018 levels (0.0109 euros per minute). The approved MTRs are as follows: from the date the decision became effective until December 31, 2018 0.0070 euros per minute; from January 1, 2019 until December 31, 2019 0.0067 euros per minute; and as from January 1, 2020 0.0064 euros per minute. The CNMC launched a public consultation in November 2018 regarding fixed termination rates ("**FTRs**"), which proposed a progressive reduction in prices of 34% from November 2018 levels. The proposed prices are as follows: from the date the decision becomes effective until December 31, 2019 0.0640 euros per minute; from January 1, 2020 until December 31, 2020 0.0591 euros per minute and as from January 1, 2021 0.0543 euros per minute. A final decision is expected to be adopted in the first quarter of 2019.

In Germany, on December 1, 2018 the price of the MTR fell from 1.07 euro cents per minute to 0.95 euro cents per minute. This price will be in force until November 30, 2019. MTRs for subsequent periods will be decided in 2019.

In Brazil, Resolution 639/2014 established that MTRs will be subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees are expected to be in force. In addition, through Act No. 6211/2014, ANATEL published the reference prices to be applied by operators with significant market power ("**SMP**"). In 2018, through Act No. 9919/2018, ANATEL published the reference prices to be applied by SMP operators from 2020 until 2023. In addition to the planned implementation of the cost-oriented-model, the Plano Geral de Metas de Competição ("**PGMC**"), amended by Resolution 649/2015, among other changes, updated the partial "bill and keep" model for MTRs, aiming to fix an imbalanced remuneration pattern between SMP operators and other companies operating in the relevant market. This measure was intended to adapt the networks to the reductions of MTRs and promote a gradual adaptation to the enforcement of the cost-oriented fees in early 2019. However, the new PGMC that was published in July 2018, among other changes, extended the "bill and keep" model, which was expected to expire in February 2019, until the next revision of the PGMC in four years.

In Mexico, on November 13, 2018, the IFT announced that the MTRs applicable to the so-called Prevailing Economic Agent ("**PEA**") for 2019 shall be 0.028313 pesos per minute while the MTRs applicable to the operators

other than the PEA shall be 0.112623 pesos per minute. Both this decision and the decision that established the MTRs applicable to 2018 were challenged by Telefónica.

In Peru, on December 21, 2018, the regulator, OSIPTEL, published the new MTRs. The new MTRs applicable to all operators of mobile public services was fixed at 0.00302 dollars per minute rated at the second, which entails a 54% decrease from the previous rate (0.0066.1 dollars per minute rated at the second). The new rates have been in effect since January 1, 2019 and will remain in effect until a new MTR value is defined by the regulator.

In Argentina, on August 17, 2018, the Ente Nacional de Comunicaciones ("**Enacom**") published the provisional termination and local origination charges for mobile communications services provided by networks until the final charges are decided pursuant to a cost model. Enacom set a tariff of 0.0108 dollars per minute and the measurement unit for valuation is per second. During the summer of 2018, Enacom launched a public consultation on the cost models for mobile communications services. On November 22, 2018, Enacom set the provisional termination charge in fixed networks at 0.0045 dollars per minute, the tariff for local transit services at 0.0010 dollars per minute, and the tariff for long distance transportation services at 0.0027 dollars per minute. In each case the measurement unit for valuation is per second.

In Chile, regarding mobile termination rates, on February 5, 2019, Subtel notified TMCH of a new proposal on tariff decree, which will be applicable for the next five years. The average tariff which will apply until 2024 is 1.8 Chilean pesos per minute (0.0024 euros, without VAT, based on the exchange rate as of February 6, 2019, to be charged on a per second basis). The new tariff decree is in effect since January 26, 2019. New tariffs on fixed operations will come into force in May 2019.

In Colombia, in December 2018, the regulator (Comisión de Regulación de Comunicaciones) published two consultations. The first initiative would reduce the FTRs from 0.01 to 0.003 dollars in 2019, which would be beneficial to ColTel as it is a net payer of FTRs. As of 2020, FTRs between fixed networks would be completely eliminated. The second initiative, on one hand seeks to substitute the national roaming charges in incoming calls charged to operators using national roaming, for mobile termination rates, which would negatively impact the revenues of ColTel; and, on the other hand, modifies the formula that defines the maximum regulated rate for network provision charged to MVNOs, from the minimum ARPU reported by MVNOs to the average ARPU from the past four (4) quarters.

As a result of the foregoing actions, the prices for certain wholesale services may be reduced, which may materially adversely affect the Group's business, financial condition, results of operations and/or cash flows. During 2018, the negative impact of these wholesale regulations (mainly MTRs, FTRs and roaming) is estimated to have resulted in the deduction of approximately 1.1 percentage points from the organic growth of the Group's revenues.

#### *Regulation of universal service obligations*

Universal service obligations ("**USO**") refers to the obligations imposed on telecommunication operators which are aimed at granting access to all consumers in a country to a minimum set of services offered at reasonable and fair prices in order to avoid social exclusion.

As stated above, Directive (EU) 2018/1972, of December 11, 2018, which approves the EECC, updates USO provisions in Europe, removing the mandatory inclusion of the legacy outdated services (payphone boxes, directories and information services) and focusing on the provision of affordable broadband services. The EECC provides Member States with full flexibility in relation to the financing required for the provision of these services, allowing Member States to choose between public or industry funding. This ample room for discretion, together with the possibility that the affordability obligations could end up being too onerous, might result in higher costs for the industry.

In Spain, Telefónica is the operator responsible for the provision of universal service elements with respect to fixed network access with a broadband bandwidth of at least 1 Mb per second (until December 2019). On December 28, 2018, the government approved (by Royal Decree 1517/2018) the modification of the USO

framework, eliminating the obligation to provide telephone directories to users (which had been assigned from January 1, 2017 to Telefónica), but maintaining Telefónica's designation as the operator responsible for the provision of public payphones until December 31, 2019, date on which it is expected that such obligation will be removed.

In Brazil, the General Plan of Universalization Targets (PGMU IV) of Fixed Switched Telephony Services (the "General Plan") that was due to have been published in 2016 was finally published on December 21, 2018 (Presidential Decree n. 9.619/2018) after a long period of discussion.

The General Plan lessens the USO framework in three ways: (i) there is a material decrease in the maintenance obligations with respect to Public Use Terminals; (ii) there is a material reduction of the obligations to meet requests for installation of individual accesses within seven days; and (iii) the extinction of the obligations to install and maintain Multifacilities Service Stations.

However, the General Plan imposes a new obligation with respect to "fixed wireless access systems with support for broadband connection" through the implementation of a base radio station in 310 pre-determined localities in the State of São Paulo.

The imposition on the Telefónica Group of additional or more onerous USO in the jurisdictions where it operates could have a material adverse effect on its business, financial condition, results of operations and/or cash flows.

#### *Regulation of fiber networks*

In Spain, on March 6, 2018, the CNMC approved a final decision on the economic replicability methodology (or ERT in its acronym in English) to be used to assess the maximum wholesale access price which Telefónica can charge other operators for accessing the optical fiber network in regulated areas (NEBA Local and NEBA services). According to this methodology, from April 2018, Telefónica is to apply a wholesale access price (NEBA) of 17.57 euros per month, with this price being updated twice a year in order to assess whether Telefónica's retail offers (broadband flagship products) are economically replicable with such wholesale NEBA price. In July 2018, the CNMC approved a final decision on the methodology to assess if Telefónica's retail offers for the business sector can be replicated by other operators.

This and any other similar obligations and restrictions which may be imposed in the future in the various jurisdictions where the Telefónica Group operates could raise costs and limit Telefónica's flexibility in providing the aforementioned services, which could materially adversely affect Telefónica's business, financial condition, results of operations and/or cash flows.

*Regulations on privacy*

In Europe, the General Data Protection Regulation ("**GDPR**") of April 27, 2016, has been directly applicable in all Member States since May 25, 2018 and implementing measures have been introduced by Member States, including Spain, Germany and the United Kingdom.

In Spain, on December 5, 2018 the Personal Data Protection and Digital Rights Act was approved. This Act implements GDPR in Spain, addressing several particularities concerning data blocking for judicial purposes or specific matters on databases for advertising purposes or data relating to deceased people. Equally, it implements procedural mechanisms within the framework of legal investigations concerning potential infringements of the GDPR.

In addition, on January 10, 2017, the EC presented its proposal for a regulation on privacy and electronic communications ("**ePrivacy Regulation**"), which will replace the current Directive 2002/58/EC. The proposal implies an extra layer of regulation on top of the GDPR and also introduces administrative fines of up to 4% of an undertaking's annual global turnover for breaching new regulations. In this area, a strict data protection and privacy regulation may result in limitations on the ability to offer innovative digital services such as big data services. The future ePrivacy Regulation is not expected to be adopted before the end of 2019.

The Privacy Shield, approved by the EC on July 12, 2016 to lay out the framework for the international transfer of personal data from the EU to the US, was challenged before the EU's General Court by civil-society groups. One of the appeals was not admitted and the admission of a second appeal is still pending as of the date of this Annual Report. The results of the second annual revision of the Privacy Shield by the Commission were published on December 19, 2018. The report concludes that the United States continues to guarantee an adequate level of protection of transferred personal data under the Privacy Shield and that the measures adopted by US authorities to implement the recommendations made by the Commission in the 2017 report have improved the functioning of the framework.

In Brazil, the Personal Data Protection Act (Act 13709/2018) was approved on August 14, 2018. This Act entails further obligations and restrictions for operators in relation to the collection of personal data and its processing and is based on the GDPR. The text was approved in the Chamber of Deputies and the Senate but the President vetoed the creation of the Authority for the Protection of Personal Data and of the National Council for the Protection of Personal Data and Privacy, after considering them to be unconstitutional. On December 27, 2018 the President of Brazil signed provisional measure 869/2018 that created the National Data Protection Authority (ANPD) and postponed to August 2020 the entry into force of the new Personal Data Protection Act. The approval of provisional measure 869/2018 by the National Congress and its conversion into law is still pending.

In Chile and Argentina, two bills aligned with the GDPR are in process to pass into law.

Any obligations and restrictions arising from privacy regulations could raise costs and limit Telefónica's ability to provide certain services, which could materially adversely affect Telefónica's business, financial condition, results of operations and/or cash flows.

*Regulation of network neutrality*

Under the principle of network neutrality applicable to the Internet access services realm, network operators are not permitted to establish technical or commercial restrictions regarding the terminals that can be connected or the services, or applications and contents that can be accessed or distributed through the Internet by the end user. It also refers to the non-discriminatory behavior (e.g. non-anticompetitive) to be adopted by operators regarding the different types of Internet traffic circulating through their networks.

Net neutrality regulation is being implemented all across Europe and in most of the Latin America countries where Telefónica is operating.

In Mexico, it is expected that IFT will issue guidelines during 2019.

Any changes to regulation as it is established in the various jurisdictions where the Telefónica Group operates, could limit the commercial flexibility and might have an impact on its business, financial condition, results of operations and/or cash flows of the Group.

**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 US Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanctions programs, including those administered by the United Nations, the European Union and the United States, including the US 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 the Group's reputation and result in other consequences, that could have a material adverse effect on the Group's business, results of operations and financial condition.

As of the date of this Annual Report, Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica continues to cooperate with governmental authorities and continues with the ongoing investigations. Although it is not possible at this time to predict the scope or duration of these matters or their likely outcome, Telefónica believes that, considering the size of the Group, any potential penalty as a result of the resolution of these investigations would not materially affect the Group's financial condition.

**Telefónica may not anticipate or adapt in a timely manner to changing customer demands and/or new ethical or social standards, which could adversely affect Telefónica's business and reputation.**

To maintain and improve its position in the market vis-à-vis its competitors, it is vital that Telefónica has the ability to anticipate and adapt to the evolving needs and demands of its customers, and that it avoids commercial actions that may generate a negative perception of the Group or the products and services it offers, or that may have or be perceived to have a negative impact on society. In addition to harming Telefónica's reputation, such actions could also result in fines and other sanctions.

There is growing social and regulatory demand for companies to behave in a socially responsible manner. In addition, the risks associated with potential damage to a brand's reputation have become more relevant, especially due to the impact that the publication of news through social networks can have.

If Telefónica were not able to anticipate or adapt to the evolving needs and demands of its customers or avoid inappropriate actions, its reputation could be adversely affected or it could otherwise have an adverse effect on the business, financial condition, results of operations and/or cash flows of the Group.

**Telefónica's competitive position in some markets could be affected by the evolution of competition and market consolidation.**

The Telefónica Group operates in highly competitive markets and it is possible that the Group may not be able to market its products and services effectively or respond successfully to the different commercial actions



carried out by its competitors. The Group may also fail to meet its growth plans or to retain its customers, any of which may result in the decrease of the Group's profits and revenue margins.

In addition, increased market concentration, including as a result of mergers and acquisitions, or alliances and collaboration agreements among other industry players, could adversely affect the competitive position of Telefónica, as well as the efficiency of its operations and its business continuity.

The entry of new competitors into markets where Telefónica is a leader, in addition to changes in market dynamics which have led to aggressive data offers and broadband deployments by the Group's competitors and mergers of operators in certain markets, have adversely affected the competitive position of Telefónica, negatively impacting the evolution of revenues and its share of customers.

If Telefónica is not able to face the challenges posed by its competitors, the business, financial condition, results of operations and/or cash flows of the Group could be negatively affected.

**Telefónica operates in a sector characterized by rapid technological changes and it may not be able to anticipate and adapt to such changes or select the right investments to make.**

The pace of innovation and Telefónica's ability to keep up with its competitors is a critical issue in a sector so affected by technology such as telecommunications.

While automation and other digital processes may lead to significant cost and efficiency gains, there are also significant risks associated with such transformation processes.

New products and technologies are constantly emerging that can render products and services offered by the Telefónica Group obsolete, as well as its technology. In addition, the explosion of the digital market and the entrance of new players in the communications market, such as MNVOs, Internet companies or device manufacturers, could imply the loss of value of certain assets, affect the generation of income, or otherwise cause Telefónica to have to update its business model. This forces Telefónica to invest in the development of new products, technology and services in order to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. Additionally, this investment may not lead to the development or commercialization of successful products or services. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are derived from mobile Internet and connectivity services that are being launched. Examples of these services include IPTV services, IoT services, financial, security and cloud services.

Research and development costs amounted to 947 million euros in 2018, representing an increase of 9.8% from 862 million euros in 2017 (906 million euros in 2016). These expenses represented 1.9%, 1.7% and 1.7% of the Group's consolidated revenues in 2018, 2017 and 2016, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development ("OECD") manual.

One of the technologies currently being developed by telecommunications operators, including Telefónica (in Spain and Latin America), is the new FTTx type networks, which allow to offer broadband accesses over fiber optics with high performance, such as 600MB Internet connections or high definition television services. However, the deployment of such networks, in which the copper of the access loop is totally or partially replaced by optical fiber, implies high levels of investments. As of December 31, 2018, in Spain, fiber coverage reached 21.3 million premises. There is a growing demand for the services that these new networks can offer to the end customer. However, the high level of investments required by these networks results in the need to continuously consider the expected return on investment, and no assurance can be given that these investments will be profitable.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to adequately support and evolve to respond to Telefónica's operating requirements is a key factor in the commercial development, customer satisfaction and business efficiency of the Telefónica Group. Any failure by the Telefónica Group to develop or implement IT systems that adequately support and respond to the Group's evolving operating

requirements could have an adverse effect on the Group's business, financial condition, results of operations and/or cash flows.

If Telefónica were not able to anticipate and adapt to the technological changes and trends in the sector, or to properly select the investments to be made, this could negatively affect the Group's business, financial condition, results of operations and/or cash flows.

**Telefónica 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 Telefónica's operations, and may cause legal contingencies or damages to its image in the event that a participant in the supply chain engages in practices that do not meet acceptable standards or that otherwise fail to meet Telefónica's performance expectations. This may include delays in the completion of projects or deliveries, poor-quality execution, cost deviations and inappropriate practices.

As of December 31, 2018, the Telefónica Group depended on two handset suppliers and ten network infrastructure suppliers, which, together, accounted for 71% and 80%, respectively, of the total contracted handsets as of such date. One of the handset suppliers represented 42% of all contracted handsets as of such date.

These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements or for other reasons. In addition, the suppliers on which Telefónica relies may also be subject to litigation with respect to technology on which Telefónica depends, including litigation involving claims of patent infringement. Such claims are frequently made in the communications industry.

If suppliers cannot supply their products to the Telefónica Group within the agreed deadline or such products and services do not meet the Group's requirements, this could hinder the deployment and expansion plans of the network, which in certain cases could affect Telefónica's compliance with the terms and conditions of the licenses under which it operates, or otherwise adversely affect the business and operating results of the Telefónica Group. In addition, the possible adoption of new protectionist measures in certain parts of the world, including as a result of trade tensions between the United States and China, may have an adverse impact on certain of Telefónica's suppliers and other significant players in the industry.

The imposition of trade restrictions could result in higher costs and lower margins, and could adversely affect the Group's business, financial condition, results of operations and/or cash flows.

**Unanticipated network interruptions can lead to quality loss or the interruption of the service.**

Unforeseen network interruptions due to system failures, including those due to natural disasters caused by natural or meteorological events or phenomena, network failures, hardware or software failures, theft of network elements or cyber-attacks that affect the quality of, or cause interruption to, the provision of the services of the Telefónica Group, could cause customer dissatisfaction, a reduction in revenues and traffic, the realization of expensive repairs, the imposition of sanctions or other measures by regulatory bodies, and damage to the image and reputation of the Telefónica Group or could otherwise have an adverse effect on the business, financial condition, results of operations and/or cash flows of the Group.

**Information technology is key to the Group's business and it could be subject to cybersecurity risks.**

The Group operates in an environment increasingly prone to cyber-threats. Consequently, it is necessary for the Group to continue to advance its capacity to identify and detect technical threats and vulnerabilities and improve its ability to react to incidents. This includes the need to strengthen security controls in the supply chain as well as to place increased focus on security measures adopted by partners of the Group and other third parties.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses have become increasingly dependent on telecommunications and computer networks and have adopted cloud computing technologies. Cybersecurity threats may include gaining unauthorized access to Telefónica's systems or inserting computer viruses or malicious software in its systems to misappropriate consumer data and other sensitive information, corrupt Telefónica's data or disrupt its operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, data devices and mobile phones and intelligence gathering by employees with access. Further, the Group's employees or other persons may have unauthorized or authorized access to the Group's systems and/or take actions that affect the Group's networks in an inconsistent manner with the Group's policies or otherwise adversely affect the Group or its ability to adequately process internal information.

Telefónica attempts to mitigate these risks through a number of measures, including backup, log review, vulnerabilities checks, network segregation measures and protective systems such as firewalls, intrusion detection or prevention systems, virus scanners and other physical and logical security measures. However, the application of these measures may not always be effective. The Telefónica Group has insurance policies in place which could cover, subject to the policies terms, conditions, exclusions, limits and sublimits of indemnity, and deductibles applying, certain losses arising out of this type of incidents. To date the insurance policies in place have covered some incidents of this sort, yet due to the potential severity and uncertainty of the mentioned events, these policies may not be sufficient to cover all possible monetary losses arising out of an individual event.

**Possible regulatory, business, economic or political changes and other factors 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 impairments in goodwill, intangible assets, property, plant and equipment or financial assets. Although the recognition of impairments of these 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. In 2018, impairment losses in the value of goodwill, have been recognized amounting to 350 million euros, related to Telefónica's operations in Mexico. No impairments were recognized in 2017. In 2016, impairment losses, in the value of goodwill, were recognized amounting to 215 million euros, related to Telefónica's operations in Venezuela (124 million euros) and in Mexico (91 million euros). In addition, Telefónica may not be able to realize deferred tax assets on its statement of financial position to offset future taxable income. The recoverability of deferred tax assets depends on the Group's ability to generate taxable income over the period for which the deferred tax assets remain deductible. If Telefónica believes it is unable to utilize its deferred tax assets during the applicable period, it may be required to record an impairment against them resulting in a non-cash charge on the income statement. In 2018, Telefónica Móviles México derecognized deferred tax assets amounting to 327 million euros. Further details on intangible assets and goodwill are provided in Notes 6 and 7 to the Consolidated Financial Statements.

**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 effect on the business, financial position, results of operations and/or cash flows of the Group.

**Telefónica and Telefónica Group companies are party to lawsuits, antitrust, tax claims and other legal proceedings.**

Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust 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/or 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 and regulatory proceedings in Brazil, primarily relating to the ICMS (a Brazilian tax on telecommunication services) and the corporate tax. Further details on these matters are provided in Notes 22 and 26 to the Consolidated Financial Statements. Additional details on provisions for litigation, tax sanctions and claims can be found in Note 21 to the Consolidated Financial Statements.

**The telecommunications industry could be affected by factors related to sustainability and the environment. It could also be affected by the possible effects that electromagnetic fields could have on health.**

Telefónica's operations and assets (including its towers and submarine cables) are located in many areas that are subject to natural disasters and severe weather, and which may be adversely affected in the future by climate change. Climate-related factors, such as heat waves, drought, sea levels, storms or flooding, could lead to unanticipated network interruptions and costly repairs, and negatively impact the demand for Telefónica's services in affected areas. Furthermore, if the Group's insurance did not fully cover business interruptions or losses resulting from these events, any of the foregoing could have an adverse effect on the business, financial position, results of operations and/or cash flows of the Group.

In addition, government restrictions, standards, or regulations intended to reduce greenhouse gas emissions or potential climate change impacts are likely to result in increased energy, transportation, or raw material and other supply costs. Moreover, local, national or international policy responses to climate change, such as carbon pricing or levies, emission caps or subsidy withdrawals may also lead to the stranding or financial impairment of certain of the Group's assets. Furthermore, the Group may face increased reputational pressure if its activities are perceived to be inconsistent with addressing climate change.

While the Group has taken several steps to increase its resilience to climate change and to limit its carbon footprint, there is no certainty as to whether such steps will be effective or sufficient.

The telecommunications industry could also be affected by the possible effects that electromagnetic fields emitted by mobile devices and base stations could have on health, as well as by concerns relating to such matters. These concerns have led some governments and administrations to take measures that have compromised the deployment of the necessary infrastructures to ensure quality of service, and have affected the criteria for the deployment of new networks and the development of digital services such as smart meters.

There is consensus among several groups of experts and public health agencies, including the World Health Organization, who state that, to date, there have been no proven risks of exposure to low radio-frequency signals from mobile communications. The scientific community continues to investigate this issue, especially with regard to mobile devices.

Concerns about electromagnetic fields may discourage the use of mobile telephony and new digital services, and may lead government authorities to impose significant restrictions on the location and operation of antennas or cells and the use of radio frequencies by mobile phones, as well as the deployment of smart meters and other products that use mobile technology. This could lead to the impossibility of expanding or improving the Group's mobile network.

Any of the foregoing could have an adverse effect on the business, financial position, results of operations and/or cash flows of the Group.



*This version of our report is a free translation of the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

## **INDEPENDENT REASONABLE ASSURANCE REPORT ON THE DESIGN AND EFFECTIVENESS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)**

To the Board of Directors of Telefónica, S.A.:

We have carried out a reasonable assurance report of the design and effectiveness of the Internal Control over Financial Reporting (hereinafter, ICFR) and the description of it that is included in the attached Report that forms part of the corresponding section of the Annual Corporate Governance Report of the Directors Report accompanying the consolidated financial statements of Telefónica, S.A., and its subsidiaries (hereinafter, the Telefónica Group) as at December 31, 2018. This system is based on the criteria and policies defined by the Telefónica Group in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its "Internal Control-Integrated Framework 2013" report.

An Internal Control over Financial Reporting is a process designed to provide reasonable assurance over the reliability of financial information in accordance with the applicable financial reporting framework and includes those policies and procedures that: (i) enable the records reflecting the transactions performed to be kept accurately and with a reasonable level of detail; (ii) provide reasonable assurance as to the proper recognition of transactions to make it possible to prepare the financial information in accordance with the accounting principles and standards applicable to it and that they are made only in accordance with established authorizations; and (iii) provide reasonable assurance in relation to the prevention or timely detection of unauthorised acquisitions, use or sales of the Group's assets that could have material effect on the financial information.

### **Inherent Limitations**

In this regard, it should be borne in mind that, given the inherent limitations of any Internal Control over Financial Reporting, regardless of the quality of the design and operation of the system, it can only allow reasonable, but not absolute security, in relation to the objectives it pursues, which may lead to errors, irregularities or fraud that may not be detected. On the other hand, the projection to future periods of the evaluation of internal control is subject to risks such that said internal control being inadequate as a result of future changes in the applicable conditions, or that in the future the level of compliance of the established policies or procedures may be reduced.

### **Director's responsibility**

The Directors of Telefónica, S.A. are responsible for taking the necessary measures to reasonably ensure the implementation, maintenance and supervision of an appropriate Internal Control over Financial Reporting, as well as the evaluation of its effectiveness, the development of improvements to that system and the preparation and establishment of the content of the information relating to the ICFR attached.



## **Our Responsibility**

Our responsibility is to issue a reasonable assurance report on the design and effectiveness of the Telefónica Group Internal Control over Financial Reporting, based on the work we have performed and on the evidence we have obtained. We have performed our reasonable assurance engagement in accordance with "International Standard on Assurance Engagements 3000 (ISAE 3000)" (Revised), "Assurance Engagements other than Auditing or Reviews of Historical Financial Information", issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).

A reasonable assurance report includes the understanding of the Internal Control over Financial Reporting, assessing the risk of material weaknesses in the internal control, that the controls are not properly designed or they do not operate effectively, the execution of tests and evaluations on the design and effective implementation of this ICFR, based on our professional judgment, and the performance of such other procedures as may be deemed necessary.

We believe that the evidence we have obtained provides a sufficient and adequate basis for our opinion.

## **Our Independence and Quality Control**

We have complied with the independence requirements and other ethical requirements of the Accounting Professionals Code of Ethics issued by the International Ethics Standards Board for Accountants (IESBA), which is based on the fundamental principles of integrity, objectivity, professional competence and diligence, confidentiality and professional behavior.

Our firm applies the "International Standard on Quality Control 1 (ISQC 1)" and maintains an exhaustive qualitative control system that includes documented policies and procedures regarding compliance with ethical requirements, professional standards, and applicable legal and regulatory provisions.

## **Opinion**

In our opinion, the Telefónica Group maintained, as at December 31, 2018, in all material respects, an effective Internal Control over Financial Reporting for the period ended at December 31, 2018, which is based on the criteria and the policies defined by the Telefónica Group's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its "Internal Control-Integrated Framework 2013" report.

In addition, the attached description of the ICFR Report as at December 31, 2018 has been prepared, in all material respects, in accordance with the requirements established by article 540 of the Consolidated Text of the Capital Companies Act and with the Circular 5/2013 of June 12, 2013 of the CNMV, as amended by CNMV Circular No. 7/2015 dated December 22, 2015 and CNMV Circular No. 2/2018 dated June 12, 2018 for the purposes of the description of the ICFR in the Annual Reports of Corporate Governance.

This work does not constitute an audit nor is it subject to the regulations governing the audit activity in force in Spain, so we do not express any audit opinion in the terms provided in the aforementioned regulations.

PricewaterhouseCoopers Auditores, S.L.

A handwritten signature in blue ink, appearing to read "Virginia Arce Peralta", with a horizontal line extending to the right and a small upward-pointing arrow at the end.

Virginia Arce Peralta

February 21, 2019