Telefónica, S.A.

Auditor's Report,
Annual Accounts and Directors' Report
at December 31, 2017

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 auditor's report on the annual accounts

To the shareholders of Telefónica, S.A.:

Report on the annual accounts

Opinion

We have audited the annual accounts of Telefónica, S.A. (the Company), which comprise the balance sheet as at December 31, 2017, the income statement, statement of changes in equity, cash flow statement and related notes for the year then ended.

In our opinion, the accompanying annual accounts present fairly, in all material respects, the equity and financial position of the Company as at December 31, 2017, as well as its financial performance and cash flows for the year then ended, in accordance with the applicable financial reporting framework (as identified in note 2.a of the notes to the annual accounts), and, in particular, with the accounting principles and criteria included therein.

Basis for opinion

We conducted our audit in accordance the legislation governing the audit practice in force in Spain. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the annual accounts section of our report.

We are independent of the Company in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the annual accounts in Spain, in accordance with the legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, nor have situations or circumstances arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual accounts of the current period. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Key audit matters	How the matter was handled in the course of the audit
Valuation of investments in group companies	
A significant portion of Telefónica, S.A.'s assets corresponds to its equity investments in group companies. At 31 December 2017, as disclosed in note 8, the carrying amount of the Company's investments in group companies and associates amounted to €67,025 millon. To assess if there is an impairment in the investments in group companies, management conducts an impairment tests annually or whenever changes in circumstances or events indicate that the carrying amount may not be recoverable. As described in notes 4.c) and 8.2, when the recoverable amount is estimated by calculating the present value of the future cash flows from its investments, management bases its calculations on the strategic business plans approved by the Board of Directors. This is a key audit matter as these are complex calculations which require a significant amount of judgement, particularly when estimating key assumptions such as revenue growth, the trend in profit margins, long-term capital expenditure requirements, the discount rate and the rate of growth in perpetuity. These assumptions could be affected materially by future developments in the macroeconomic, competitive, regulatory and technological environments in each of the countries and businesses in which the group companies operate. As described in note 8.2, management has recognised an impairment loss of €1,443 million in the 2017 income statement.	We have conducted audit procedures, with the assistance of our valuation experts, to test the process followed by the directors and management to determine the recoverable amounts of the Company's investments in group companies, specifically including: • Understanding the control environment, evaluating and testing performance of the relevant controls over the process by which Telefónica calculates the present value of the future cash flows from its investments in group companies. • Verifing the consistency of the data used in the discounted cash flow calculations against the strategic business plans approved by the Board of Directors. • Analysing the level of performance regards of the strategic business plan approved in the previous year. • Assessing the key assumptions used to determine the recoverable amounts, questioning their reasonableness and coherence, to which end we compared key assumptions against market information. • Verifing that the disclosures made in the annual accounts comply with applicable accounting standards. Based on the procedures performed, we believe that the tests performed by management are reasonable, that the key assumptions estimated are within a reasonable range and that the conclusions reached by management regarding the valuation of the investments in group companies are consistent with the disclosures provided in the accompanying annual accounts.

Other matters

The annual accounts of the Company for the year ended 31 December 2016 were audited by another auditor who expressed an unqualified opinion on those annual accounts on 23 February 2017.

Other information: directors' report

Other information refers exclusively to the 2017 directors' report, the preparation of which is the responsibility of the Company's directors and is not an integral part of the annual accounts.

Our opinion on the annual accounts does not cover the directors' report. Our responsibility regarding the information contained in the directors' report is defined in the regulations governing financial statement audit work, which establish two distinct levels of responsibility:

a) A specific level applicable to the non-financial statement and to some of the information included in the Annual Corporate Governance Report, as defined in article 35.2. b) of Spanish Law 22/2015, the Audit Act, which consists of solely checking that the required information has been provided in the directors' report and, if not, stating that it has not.

b) A general level applicable to the rest of the information included in the directors' report, which consists of assessing and reporting on the consistency of the said information with the annual accounts based on the knowledge of the Company obtained in the course of auditing the said statements (not including other information not obtained as evidence during the course of the audit); and assessing and reporting on whether the content and presentation of this part of the directors' report are in conformity with applicable regulations. If, based on the work carried out, we conclude that there are material misstatements, we are required to disclose them.

Based on the work performed, as described before, we can confirm that the specific information stipulated in item a) above has been provided in the directors' report and that the rest of the information contained in the directors' report is consistent with that provided in the 2017 annual accounts and, that its content and presentation are in conformity with applicable regulations.

Responsibility of the directors and the audit and control committee for the annual accounts

The Company's directors are responsible for the preparation of the accompanying annual accounts, such that they fairly present the equity, financial position and financial performance of the Company, in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the Company's directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit and control committee is responsible for overseeing the process of preparation and presentation of the annual accounts.

Auditor's responsibilities for the audit of the annual accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with legislation governing the audit practice in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual accounts.

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Company's directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Company's audit and control committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Company's audit and control committee with a statement that we have complied with relevant ethical requirements, including those relating to independence, and we communicate with the audit and control committee those matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Company's audit and control committee, we determine those matters that were of most significance in the audit of the annual accounts of the current period and are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Report on other legal and regulatory requirements

Report to the Parent company's audit and control committee

The opinion expressed in this report is consistent with the content of our additional report to the company's audit and control committee dated 20 February 2018.

Appointment period

The General Ordinary Shareholders' Meeting held on 12 May 2016 appointed us as auditors for a period of three years, as from the year ended 31 December 2017.

Services provided

Services provided to the Company for services other than the audit of the accounts are described in note 20.g) of the accompanying annual accounts.

PricewaterhouseCoopers Auditores, S.L. (S0242)

Virginia Arce

Virginia Arce Peralta (16096)

22 February 2018

2017

TELEFÓNICA, S.A.

Annual financial statements and management report for the year ended December 31, 2017

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Telefónica, S.A.

Balance sheet at December 31

Millions of euros

ASSETS	Notes	2017	2016
NON-CURRENT ASSETS		**76,400**	**76,817**
Intangible assets	**5**	**17**	**23**
Software		8	9
Other intangible assets		9	14
Property, plant and equipment	**6**	**210**	**205**
Land and buildings		126	131
Plant and other PP&E items		48	53
Property, plant and equipment under construction and prepayments		36	21
Investment property	**7**	**389**	**399**
Land		94	94
Buildings		295	305
Non-current investments in Group companies and associates	**8**	**69,166**	**68,211**
Equity instruments		67,025	65,249
Loans to Group companies and associates		2,141	2,950
Other financial assets		—	12
Financial investments	**9**	**3,761**	**5,016**
Equity instruments		340	339
Derivatives	16	2,509	4,667
Other financial assets	9	912	10
Deferred tax assets	**17**	**2,857**	**2,963**
CURRENT ASSETS		**8,465**	**6,443**
Trade and other receivables	**10**	**575**	**447**
Current investments in Group companies and associates	**8**	**3,460**	**3,227**
Loans to Group companies and associates		3,426	3,167
Derivatives	16	10	30
Other financial assets		24	30
Investments	**9**	**1,557**	**1,942**
Loans to companies		759	42
Derivatives	16	793	1,652
Other financial assets		5	248
Accruals		**5**	**16**
Cash and cash equivalents		**2,868**	**811**
TOTAL ASSETS		**84,865**	**83,260**

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these balance sheets

Millions of euros

EQUITY AND LIABILITIES	Notes	2017	2016
EQUITY		**19,865**	**20,277**
CAPITAL AND RESERVES		**20,520**	**20,943**
Share capital	**11**	**5,192**	**5,038**
Share premium	**11**	**4,538**	**3,227**
Reserves	**11**	**10,924**	**12,928**
Legal		1,066	985
Other reserves		9,858	11,943
Treasury shares and own equity instruments	**11**	**(688)**	**(1,480)**
Profit for the year	**3**	**554**	**24**
Other equity instruments	**11**	**—**	**1,206**
UNREALIZED GAINS (LOSSES) RESERVE	**11**	**(655)**	**(666)**
Available-for-sale financial assets		42	8
Hedging instruments		(697)	(674)
NON-CURRENT LIABILITIES		**48,874**	**45,471**
Non-current provisions	**18**	**459**	**367**
Non-current borrowings	**12**	**7,314**	**7,249**
Bank borrowings	14	4,186	4,427
Derivatives	16	2,796	2,684
Other debts		332	138
Non-current borrowings from Group companies and associates	**15**	**40,642**	**37,274**
Deferred tax liabilities	**17**	**427**	**571**
Long term deferred revenues		**32**	**10**
CURRENT LIABILITIES		**16,126**	**17,512**
Current provisions	**18**	**123**	**121**
Current borrowings	**12**	**1,352**	**3,712**
Bonds and other marketable debt securities	13	204	1,158
Bank borrowings	14	896	1,635
Derivatives	16	252	679
Other financial liabilities	14	—	240
Current borrowings from Group companies and associates	**15**	**14,101**	**13,146**
Trade and other payables	**18**	**539**	**486**
Accruals		**11**	**47**
TOTAL EQUITY AND LIABILITIES		**84,865**	**83,260**

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these balance sheets

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2017	2016
Revenue	**19**	**3,715**	**2,710**
Rendering of services to Group companies and associates		558	548
Rendering of services to non-group companies		35	59
Dividends from Group companies and associates		3,027	1,928
Interest income on loans to Group companies and associates		95	175
Impairment and gains (losses) on disposal of financial instruments	**8**	**(1,130)**	**3,045**
Impairment losses and other losses		(1,443)	2,049
Gains (losses) on disposal and other gains and losses		313	996
Other operating income	**19**	**42**	**46**
Non-core and other current operating revenue - Group companies and associates		26	30
Non-core and other current operating revenue - non-group companies		16	16
Employees benefits expense	**19**	**(174)**	**(310)**
Wages, salaries and others		(149)	(281)
Social security costs		(25)	(29)
Other operational expense		**(412)**	**(356)**
External services - Group companies and associates	19	(113)	(109)
External services - non-group companies	19	(287)	(252)
Taxes other than income tax		(12)	5
Depreciation and amortization	**5, 6 and 7**	**(36)**	**(38)**
Gains (losses) on disposal of fixed assets		**2**	**(4)**
OPERATING PROFIT		**2,007**	**5,093**
Finance revenue	**19**	**411**	**922**
Finance costs	**19**	**(2,299)**	**(2,996)**
Change in fair value of financial instruments		**(30)**	**—**
Gain (loss) on available-for-sale financial assets recognized in the period	9 and 11	(30)	—
Exchange rate gains (losses)	**19**	**185**	**(170)**
Impairment and gains (losses) on disposal of financial instruments with third-parties	**9.3 and 19.9**	**—**	**17**
NET FINANCIAL EXPENSE		**(1,733)**	**(2,227)**
PROFIT BEFORE TAX	**21**	**274**	**2,866**
Income tax	**17**	**280**	**(2,842)**
PROFIT FOR THE YEAR		**554**	**24**

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these income statements

Telefónica, S.A.

Statements of changes in equity for the years ended December 31

A) Statement of recognized income and expense

Millions of euros	Notes	2017	2016
Profit of the period		**554**	**24**
Total income and expense recognized directly in equity	**11**	**(139)**	**368**
From measurement of available-for-sale financial assets		2	13
From cash flow hedges		(191)	477
Income tax impact		50	(122)
Total amounts transferred to income statement	**11**	**150**	**(244)**
From measurement of available-for-sale financial assets		30	(17)
From cash flow hedges		161	(308)
Income tax impact		(41)	81
TOTAL RECOGNIZED INCOME AND EXPENSE		**565**	**148**

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these statements of changes in equity.

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

Millions of euros	Share capital	Share premium and Reserves	Treasury shares	Profit for the year	Interim dividend	Other net equity instruments	Net unrealized gains (losses) reserve	Total
Balance at December 31, 2015	**4,975**	**21,308**	**(1,656)**	**5**	**(1,912)**	**1,206**	**(790)**	**23,136**
Total recognized income and expense	—	—	—	24	—	—	124	148
Transactions with shareholders and owners	63	(3,247)	176	—	—	—	—	(3,008)
Dividends paid (Note 11)	(74)	(739)	813	—	—	—	—	—
Transactions with treasury shares or own equity instruments (net)	137	(2,543)	—	—	—	—	—	(2,406)
Other transactions with shareholders and owners	—	35	(637)	—	—	—	—	(602)
Other movements	—	1	—	—	—	—	—	1
Appropriation of prior year profit (loss)	—	(1,907)	—	(5)	1,912	—	—	—
Balance at December 31, 2016	**5,038**	**16,155**	**(1,480)**	**24**	**—**	**1,206**	**(666)**	**20,277**
Total recognized income and expense	—	—	—	554	—	—	11	565
Transactions with shareholders and owners	—	(2,019)	792	—	—	—	—	(1,227)
Dividends paid (Note 11)	—	(2,019)	—	—	—	—	—	(2,019)
Other transactions with shareholders and owners	—	—	792	—	—	—	—	792
Other movements	154	1,302	—	—	—	(1,206)	—	250
Appropriation of prior year profit (loss)	—	24	—	(24)	—	—	—	—
Balance at December 31, 2017	**5,192**	**15,462**	**(688)**	**554**	**—**	**—**	**(655)**	**19,865**

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these statements of changes in equity.

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	Notes	2017	2016
A) CASH FLOWS FROM OPERATING ACTIVITIES		**1,414**	**3,193**
Profit before tax		**274**	**2,866**
Adjustments to profit:		**(153)**	**(2,855)**
Depreciation and amortization	5,6 and 7	36	38
Impairment of investments in Group companies and associates	8	1,443	(2,049)
Change in long term provisions		73	24
Gains on the sale of financial assets		(313)	(992)
Losses on disposal of property, plant and equipment		(3)	—
Dividends from Group companies and associates	19	(3,027)	(1,928)
Interest income on loans to Group companies and associates	19	(95)	(175)
Net financial expense		1,733	2,227
Change in working capital		**(71)**	**(132)**
Trade and other receivables		(15)	43
Other current assets		(76)	39
Trade and other payables		20	(156)
Other current liabilities		—	(58)
Other cash flows from operating activities	**21**	**1,364**	**3,314**
Net interest paid		(1,505)	(1,868)
Dividends received		2,921	4,212
Income tax receipts		(52)	970
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES	**21**	**(2,829)**	**(1,563)**
Payments on investments		(6,441)	(5,002)
Proceeds from disposals		3,612	3,439
C) CASH FLOWS USED IN FINANCING ACTIVITIES		**3,436**	**(924)**
Payments on equity instruments		**10**	**(624)**
Proceeds from financial liabilities	**21**	**5,330**	**2,095**
Debt issues		14,687	15,884
Repayment and redemption of debt		(9,357)	(13,789)
Dividends paid	**21**	**(1,904)**	**(2,395)**
D) NET FOREIGN EXCHANGE DIFFERENCE		**36**	**(5)**
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**2,057**	**701**
Cash and cash equivalents at January 1		811	110
Cash and cash equivalents at December 31		2,868	811

Notes 1 to 23 and Appendices I and II are an integral part of these cash flow statements.

TELEFÓNICA, S.A.

Annual financial statements for the ended December 31, 2017

Note 1. Introduction and general information

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

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

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

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

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

Note 2. Basis of presentation

a) True and fair view

These financial statements have been prepared from Telefónica, S.A.'s accounting records by the Company's Directors in accordance with the accounting principles and standards contained in the Spanish GAAP in force approved by Royal Decree 1514/2007, on November 16 (PGC 2007), modified by Royal Decree 602/2016, dated December 2, 2016 and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company's equity, financial position, results of operations and of the cash flows obtained and applied in 2017.

The accompanying financial statements for the year ended December 31, 2017 were prepared by the Company's Board of Directors at its meeting on February 21, 2018 for submission for approval at the General Shareholders' Meeting, which is expected to occur without modification.

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

b) Comparison of information

In 2017 and 2016 there have not been significant transactions that should be taken into account in order to ensure the comparison of information included in the Annual Financial Statements of both years.

c) Materiality

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

d) Use of estimates

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

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

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

Provisions for impairment of investments in Group companies and associates

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

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

Deferred taxes

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings, and of all the options available to achieve an outcome, it considers the most efficient one in terms of tax within the legal framework the Company is subject to. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

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

Note 3. Proposed appropriation of profit

Telefónica, S.A. obtained 554 million euros of profit in 2017. Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2017 profit for approval at the Shareholders' Meeting:

Millions of euros	
Proposed appropriation:	
Profit for the year	554
Distribution to:	
Legal reserve	51
Other reserves	503

Note 4. Recognition and measurement accounting policies

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

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

a) Intangible assets

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

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

b) Property, plant and equipment and investment property

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

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

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

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

c) Impairment of non-current assets

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

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

d) Financial assets and liabilities

Financial investments

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

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

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

Derivative financial instruments and hedge accounting

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

e) Revenue and expenses

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

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

f) Related party transactions

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

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

g) Financial guarantees

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

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

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

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

h) Consolidated data

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group's consolidated financial statements for 2017 and 2016 are as follows:

Millions of euros

Item	2017	2016
Total assets	115,066	123,641
Equity:		
Attributable to equity holders of the parent	16,920	18,157
Attributable to minority interests	9,698	10,228
Revenue from operations	52,008	52,036
Profit for the year:		
Attributable to equity holders of the parent	3,132	2,369
Attributable to minority interests	246	30

Note 5. Intangible assets

The movements in the items composing intangible assets and the related accumulated amortization in 2017 and 2016 are as follows:

2017

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	**230**	**4**	**—**	**2**	**236**
Software	140	2	—	4	146
Other intangible assets	90	2	—	(2)	90
ACCUMULATED AMORTIZATION	**(207)**	**(12)**	**—**	**—**	**(219)**
Software	(131)	(7)	—	—	(138)
Other intangible assets	(76)	(5)	—	—	(81)
NET CARRYING AMOUNT	**23**	**(8)**	**—**	**2**	**17**

2016

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	**254**	**8**	**(33)**	**1**	**230**
Software	132	3	—	5	140
Other intangible assets	122	5	(33)	(4)	90
ACCUMULATED AMORTIZATION	**(226)**	**(13)**	**33**	**(1)**	**(207)**
Software	(124)	(7)	—	—	(131)
Other intangible assets	(102)	(6)	33	(1)	(76)
NET CARRYING AMOUNT	**28**	**(5)**	**—**	**—**	**23**

At December 31, 2017 and 2016 commitments exist to acquire intangible assets amounting to 0.5 and 1.4 million euros, respectively.

At December 31, 2017 and 2016, the Company had 182 million euros and 140 million euros, respectively, of fully amortized intangible assets.

After the merger of Terra Networks, S.A. with Telefónica, S.A., in 2006 the Company registered a goodwill, which was amortized on an annual basis until the entry into force of PGC 2007. As of December 31, 2007 that asset had a net carrying amount of 33.9 million euros. Subsequently, Telefónica, S.A. tested for impairment that asset every year, which did not disclose any need to recognise a write-down. The Company has set aside 1.6 million euros annually (5% of the net carrying amount of the asset) of its net profit to a non-distributable reserve for goodwill amortization. The balance of this reserve at December 31, 2015 was 12 million euros.

After the publication of Royal Decree 602/2016, on December, 2, 2016, modifying certain aspects in PGC 2007 such as the indefinite useful life of goodwill, among others, which was was made definite again, the Company amortized the aforementioned goodwill in a retrospective way as it had not been amortized since PGC 2007 entered into force. As of December 31, 2017 these assets have been fully amortized.

Note 6. Property, plant and equipment

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2017 and 2016 are as follows:

2017

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	**569**	**22**	**(1)**	**(2)**	**588**
Land and buildings	223	—	(1)	1	223
Plant and other PP&E items	325	1	—	3	329
Property, plant and equipment under construction and prepayments	21	21	—	(6)	36
ACCUMULATED DEPRECIATION	**(364)**	**(14)**	**—**	**—**	**(378)**
Buildings	(92)	(5)	—	—	(97)
Plant and other PP&E items	(272)	(9)	—	—	(281)
NET CARRYING AMOUNT	**205**	**8**	**(1)**	**(2)**	**210**

2016

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	**572**	**8**	**—**	**(11)**	**569**
Land and buildings	232	—	—	(9)	223
Plant and other PP&E items	323	1	—	1	325
Property, plant and equipment under construction and prepayments	17	7	—	(3)	21
ACCUMULATED DEPRECIATION	**(350)**	**(14)**	**—**	**—**	**(364)**
Buildings	(89)	(3)	—	—	(92)
Plant and other PP&E items	(261)	(11)	—	—	(272)
NET CARRYING AMOUNT	**222**	**(6)**	**—**	**(11)**	**205**

Firm commitments to acquire property, plant and equipment at December 31, 2017 and 2016 amounted to 2 million euros and 3 million euros, respectively. At December 31, 2017 and 2016, the Company had 225 million euros and 205 million euros, respectively, of fully depreciated items of property, plant and equipment.

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

"Property, plant and equipment" includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 69 million euros and 70 million euros at the 2017 and 2016 year-ends, respectively. It also includes the net carrying amount of the remaining assets (mainly plant and property) of 20 and 30 million euros at December 31, 2017 and 2016, respectively. The land and buildings rented to other Group Companies have been included as "Investment properties" in Note 7.

Note 7. Investment properties

The movements in the items composing investment properties in 2017 and 2016 and the related accumulated depreciation are as follows:

2017

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	**495**	**—**	**—**	**—**	**495**
Land	94	—	—	—	94
Buildings	401	—	—	—	401
ACCUMULATED DEPRECIATION	**(96)**	**(10)**	**—**	**—**	**(106)**
Buildings	(96)	(10)	—	—	(106)
NET CARRYING AMOUNT	**399**	**(10)**	**—**	**—**	**389**

2016

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	**486**	**—**	**—**	**9**	**495**
Land	94	—	—	—	94
Buildings	392	—	—	9	401
ACCUMULATED DEPRECIATION	**(85)**	**(11)**	**—**	**—**	**(96)**
Buildings	(85)	(11)	—	—	(96)
NET CARRYING AMOUNT	**401**	**(11)**	**—**	**9**	**399**

“Investment properties” mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at Distrito Telefónica, headquarters in Madrid and the building of its head offices in Barcelona, known as “Diagonal 00”.

In 2017, the Company has buildings with a total area of 310,389 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 91.22% of the buildings it has earmarked for lease. In 2016, it had a total of 311,128 square meters leased, equivalent to an occupancy rate of 95.35% of the buildings earmarked for lease.

Total income from leased buildings in 2017 (see Note 19.1.a.) amounted to 45 million euros (44 million euros in 2016). Future minimum rentals receivable under non-cancellable leases are as follows:

	2017	2016
Millions of euros	Future minimum recoveries	Future minimum recoveries
Up to one year	40	40
Between two and five years	1	5
Over 5 years	—	1
Total	**41**	**46**

The most significant lease contracts held with subsidiaries occupying Distrito Telefónica have been renewed in 2017 for a non-cancellable period of 12 months. The numbers also include non-cancellable lease revenues from Diagonal 00, whose contracts have an expiration date in December 2018.

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

Note 8. Investments in group companies and associates

8.1. The movements in the items composing investments in Group companies and associates in 2017 and 2016 are as follows:

2017

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Net investment hedges	Closing balance	Fair value
Equity instruments (Net) (1)	**65,249**	**2,864**	**(965)**	**(22)**	**—**	**—**	**(101)**	**67,025**	**122,904**
Equity instruments (Cost)	91,178	4,307	(980)	(1,687)	—	—	(101)	92,717	
Impairment losses	(25,929)	(1,443)	15	1,665	—	—	—	(25,692)	
Loans to Group companies and associates	2,950	44	(361)	(406)	(86)	—	—	2,141	2,172
Other financial assets	12	5	—	(17)	—	—	—	—	—
Total non-current investment in Group companies and associates	**68,211**	**2,913**	**(1,326)**	**(445)**	**(86)**	**—**	**(101)**	**69,166**	**125,076**
Loans to Group companies and associates	3,167	3,750	(3,856)	406	(41)	—	—	3,426	3,020
Derivatives	30	10	(30)	—	—	—	—	10	10
Other financial assets	30	9	(32)	17	—	—	—	24	24
Total current investments in Group companies and associates	**3,227**	**3,769**	**(3,917.8)**	**423**	**(41)**	**—**	**—**	**3,460**	**3,054**

(1) Fair value at December 31, 2017 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

2016

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Net investment hedges	Closing balance	Fair value
Equity instruments (Net) (1)	**47,971**	**6,446**	**(236)**	**12,338**	**—**	**(619)**	**(651)**	**65,249**	**127,748**
Equity instruments (Cost)	62,182	4,397	(285)	26,154	—	(619)	(651)	91,178	
Impairment losses	(14,211)	2,049	49	(13,816)	—	—	—	(25,929)	
Loans to Group companies and associates	2,313	1,853	(1,315)	191	(92)	—	—	2,950	2,985
Other financial assets	16	11	—	(15)	—	—	—	12	12
Total non-current investment in Group companies and associates	**50,300**	**8,310**	**(1,551)**	**12,514**	**(92)**	**(619)**	**(651)**	**68,211**	**130,745**
Loans to Group companies and associates	7,426	1,293	(5,400)	(181)	29	—	—	3,167	3,171
Derivatives	40	30	(40)	—	—	—	—	30	30
Other financial assets	38	6	(29)	15	—	—	—	30	30
Total current investments in Group companies and associates	**7,504**	**1,329**	**(5,469)**	**(166)**	**29**	**—**	**—**	**3,227**	**3,231**

(1) Fair value at December 31, 2016 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

The most significant transactions occurred in 2017 and 2016 as well as their accounting impacts are described below:

2017

On February 10, 2017 Telefónica and Taurus Bidco S.à.r.l. (hereinafter"KKR", an entity managed by Kohlberg Kravis Roberts & Co. L.P.) reached an agreement for the sale of up to 40% of the share capital of Telxius Telecom, S.A.U. in exchange for an aggregate amount of 1,275 million euros (12.75 euros per share).

The agreement envisaged a sale of 62 million shares of Telxius Telecom, S.A.U. (representing 24.8% of its share capital) for an amount of 790.5 million euros as well as a call option over additional 38 million shares (representing 15.2% of its total share capital) for a minimum price of 484.5 million euros.

On October 24, 2017, Telefónica announced that, after obtaining all the relevant regulatory approvals, it has transferred to KKR 62 million shares of Telxius with a profit of 191 million euros. On December 13, 2017 KKR exercised the call option foreseen in the agreement over 38 million shares of Telxius Telecom, S.A.U. in exchange for 484.5 million euros resulting in an income on the "Gain on disposals" caption of the income statement amounting to 120 million euros.

The Group is carrying out a simplification process of corporate structure and pursuant to this process several mergers by absorption have been completed in 2017. The net book value of the absorbed companies has been accounted for in the surviving company as an increase in its investment cost. Therefore the cost and the impairment provision of the absorbed investments have been reversed. This movement is shown as "Tranfers" in 2017 chart of movements.

The merger transactions affecting 2017 investments are the following:

- In September 2017 Telefónica Latinoamérica Holding, S.L. carried out a merge by absorption of Telefónica Datacorp, S.A. and Ecuador Cellular Holding, S.L., which were both direct subsidiaries of Telefónica, S.A.
- On the same date, Telefónica Digital Holding, S.L.U. was merged and absorbed by Telefónica Digital España, S.L.U., and after this transaction the latter company becomes a direct affiliate of Telefónica, S.A.
- In November, 2017 Telefónica Móviles Argentina Holding, S.A. was merged to Telefónica Móviles Argentina, S.A. After this transaction the Company increased its direct ownership from 21.1% to 73.2%.
- In December 2017, Telefónica International Wholesale Services II, S.L. carried out a merge by absorption of Telefónica International Wholesale Services, S.L., which was a direct affiliate of Telefónica, S.A.

2016

Following the decision of the European Commission to prohibit the sale of Telefónica Europe, plc to the Hutchison Whampoa group, and as a consequence of the strategy approved by the Board of Directors of Telefónica at its meeting held on June 29, 2016, the investment in the company which was previously considered as a "Held for sale asset" was reclassified to the "Long Term investment in Group companies and associates" caption amounting to 12,501 million euros. The reclassification is shown in 2016 chart of movements under the "Transfers" column.

During the first semester of 2016, Telefónica decided to rearrange the assets related to infrastructures of the Group, including the telecommunication towers as well as the network of underwater and terrestrial optic fiber, unifying the concept within the same holding company (Telxius Telecom, S.A.U.). In the framework of this reorganization the following investing transactions have been made by Telefónica, S.A.:

- On January 29, 2016, Telefónica Internacional, S.A.U. sold at its net book value the 50% of its stake in Telefónica América, S.A. to Telefónica, S.A. After this transaction Telefónica, S.A. became the sole stakeholder of Telefónica América, S.A.U. On March 7th, 2016, the company's denomination was changed to Telxius Telecom, S.A.U. Telxius Telecom, S.A.U. was thus designated to be the parent company of the rearranged group of the above mentioned infrastructure entities.

- On February 16, 2016 Telefónica Móviles España, S.A.U. carried out a partial split-off of Wireless Towers, S.L.U. (a newly-incorporated company renamed after as Telxius Torres España, S.L.U.) with the aim of placing in this new company the business line of ownership and exploitation of mobile phone towers. Telefónica, S.A. recorded the split-off transaction at book value of the assets (214 million euros), and therefore it was not reflected in the chart of movements.

- On March 28, 2016 Telefónica International Wholesale Services América, S.A. executed a capital increase of 187 million dollars fully subscribed and paid pro-rata by the shareholders. The transaction implied a disbursement of 122 million euros for Telefónica, S.A., included as “Additions” in the 2016 chart of movements. The funds were used to compensate prior years’ negative reserves before the nonmonetary contribution of the company to Telxius Telecom, S.A.U. The contribution was completed on March 31 at its book value (448 million euros), and therefore it was not reflected in the chart of movements above.

- On March 30, 2016 Telxius Telecom, S.A.U. made a capital increase of 1,450 million euros fully subscribed and paid by the Company. On May 27, 2016 an additional capital increase was carried forward amounting to 502 million euros, also fully subscribed and paid by Telefónica, S.A. The total amount of these transactions was shown as Additions in 2016 chart.

- On March 31, 2016, Telxius entered into a purchase agreement to acquire all the shares of Telxius Torres España, S.L.U. from Telefónica, S.A. at fair value (1,210 million euros). The profit of the transaction amounted to 996 million euros in the income statement of Telefónica, S.A.

Other movements

In 2016 the column “Dividends” contained a distribution of reserves made by Telco TE, S.p.A. amounting to 603 million euros. These reserves were originated prior to the investment in the company.

Movement in “Transfers” in “Loans to Group Companies and Associates” both 2017 and 2016 mainly includes the reclassification between long-term and current loans in accordance with the loan maturity schedule as well as the accrued interests rendered by those loans, outstanding at year end.

“Impairment losses” Transfers in both 2017 and 2016 corresponds to the reclassification of the negative carrying amount of certain investments from the non-current provisions caption (see Note 18) amounting to -22 and -163 million euros, respectively.

In 2017 and 2016, Telefónica, S.A. bought and sold the following shareholdings:

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

Millions of euros

Companies	2017	2016
Telefónica Latinoamérica Holding, S.L.	3,838	—
Telxius Telecom, S.A.U.	—	1,952
Telefónica de Contenidos, S.A.U.	—	733
Telefónica Digital Holding, S.L.U. (absorbed by Telefónica Digital España, S.L.U.)	220	301
Telefónica Móviles Argentina Group	—	327
Lotca Servicios Integrales, S.L.	85	—
Telefónica Móviles México, S.A. de C.V.	129	548
Telefónica Global Technology, S.A.U.	—	202
Other companies	35	334
Total Group companies and associates	**4,307**	**4,397**

2017

On January 26, 2017 Telefónica Latinoamérica Holding, S.L. has made a capital increase totaling 747 million euros fully subscribed and paid by Telefónica, S.A. Additionally, on December 21, 2017, Telefónica Latinoamérica Holding, S.L. increased its share capital in 3,091 million euros. The transaction has been fully subscribed and paid by the Company.

On January 12, 2017, with the aim of achieving a positive Equity figure, Telefónica Digital Holding, S.L.U. (absorbed by Telefónica Digital España, S.L.U.) has made a capital increase of 220 million euros fully subscribed and paid by the Company.

On May 4, 2017 the Company has decided to capitalize the credits granted in previous years to Lotca Servicios Integrales, S.L. amounting to 85 million euros.

On January 12, 2017 Telefónica Móviles México, S.A. de C.V. has completed a capital increase of 3,000 million Mexican pesos, equivalent to 129 million euros. The transaction has been fully subscribed and paid by Telefónica, S.A.

2016

Additions related to Telxius Telecom, S.A.U. have been fully described at the beginning of this Note. In 2016 "Other companies" included the amount of the capital increase carried out by Telefónica International Wholesale Services América, S.A. amounting to 122 million euros also detailed at the beginning of this Note.

On January 27, 2016 Telefónica de Contenidos, S.A.U. made a capital increase amounting to 733 million euros totally subscribed and paid by the Telefónica, S.A.

On April 5, 2016 and with the aim of financing its British subsidiary Telefónica Digital, Ltd., Telefónica Digital Holding, S.L.U. executed a capital increase of 301 million euros fully subscribed and paid by its shareholder Telefónica, S.A.

On May 1, 2016 Telefónica, S.A. granted Telefónica Móviles Argentina Holdings, S.A. with credits over Telefónica Móviles Argentina, S.A. amounting to a total of 1,110 million Argentinian pesos (68 million euros), including principal and accrued interests. On May 5, 2016 the Company subscribed a capital increase launched by Telefónica Móviles Argentina, S.A., pro-rata its stake, with a disbursement of 174 million Argentinian pesos, equivalent to 11 million euros. In addition, on June 16, 2016, Telefónica, S.A. made an irrevocable capital contribution of 280 million dollars (248 million euros) in Telefónica Móviles Argentina, S.A. After this contribution the Company has increased its stake form 15.4% to 21.1%.

In order to provide Telefónica México, S.A. de C.V. with the funds needed to cancel credit lines, in December 2016 the subsidary made a capital increase amounting to 548 million euros fully subscribed and paid by its sole stakeholder, Telefónica, S.A.

As of June 22, 2016 Telefónica, S.A. capitalized all the equity loans given to its subsidiary Telefónica Global Technology, S.A.U. amounting to 202 million euros.

b) Disposals of investments and capital decreases:

Millions of euros

Companies	2017	2016
Telxius Telecom, S.A.U.	960	—
Telxius Torres España, S.L.U.	—	214
Others	20	71
Total Group companies and associates	**980**	**285**

2017

The disposal of Telxius, S.A.U. refers to the sale of shares to KKR, as fully described at the beginning of this Note.

2016

Disposal of Telxius Torres España, S.L.U. refers to the sale of this subsidiary to Telxius Telecom, S.A.U. at fair value amount (1,210 million euros), as detailed at the beginning of the Note.

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

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net debt), considering the percentage of ownership in each subsidiary and translated to euros at the official closing rate of each currency at December 31. Moreover, and only for the companies where discounted cash flow analysis is not available, due to the specific nature of their businesses, the impairment is calculated by comparing their Equity figure as of the end of the period and the net book value of those investments.

As a result of these estimations and the effect of the net investment hedge in 2017, an impairment provision of 1,443 million euros was recognized (write down reversal of 2,049 million euros in 2016). This amount derives mainly from the following companies:

(a) write down of 510 million euros for Telefônica Brasil, S.A. (reverse of the write down amounting to 2,491 million euros in 2016) and 113 million euros for Sao Paulo Telecomunicaçoes, Ltda (a reversal of 705 million euros in 2016).

(b) write down, net of hedges, of 460 million euros for Telefónica Europe, plc (582 million euros, net of hedges, in 2016).

(c) reversal of write down by 96 million euros for Telefónica México, S.A. de C.V. (write down by 1,264 million euros in 2016).

(d) In 2017 no write down has been recorded for the investment of Telefónica Latinoamérica Holding, S.L. In 2016 there was a reversal of the write down of 1,133 million euros booked in 2015, mainly due to the revaluation of the Brazilian Real which had a positive impact in the investments of 36.01% stake in Telefônica Brasil, S.A.

(e) write down of 177 million euros for Telefónica Contenidos, S.A.U. (11 million euros in 2016).

(f) write down of 93 million euros for Telefónica Digital Holding, S.L.U. (232 million euros in 2016). In addition, after the merger of the company with Telefónica Digital España, S.L.U., a write down of 48 million euros in connection with this last company has been registered.

Main hypothesis used for the calculation of the discounted cash flows of investments

Brazil has suffered in 2017 adverse macro-finance effects. Firstly, and most remarkable, the appreciation of the exchange rate has resolved into an decrease in the value of the assets nominated in Brazilian reales by 14%. Secondly, even if there is an ongoing improvement in the macroeconomic scenario and more favorable financial figures, Brazilian economy growth rate in 2017 has performed 1% below its target. Whereas tax balances have improved thanks to revenue increases, uncertainties about the economic sustainability in the long term still remain because key structural changes, such as the change in the Social Security system, which would have reinforced other changes such as the government expenditure ceiling, have not been approved. The operating income before depreciation and amortization (OIBDA) margin for Brazil is in line with the average of analysts' long term forecasts for the company, at approximately 37%. With respect to capex investments, the operator will invest a percentage in line with the investment needs identified by analysts (17%). Discount rate of 10.9% is slightly lower than the rate used in 2016 (11.3%), in line with the expectations of the analysts' consensus. The perpetuity growth rate for 2017 (4.5%) is 0.5 p.p. lower than the one used in 2016 and in line with analysts' consensus for the company. It is also consistant with the Brazilian Central Bank's medium-term inflation target (4.5%, within a range of ±1.5 p.p.) and aligned with the analyst consensus for the Strategic Plan horizon (around 4%) and below the forecast nominal GDP growth rate (which oscillates around 7%). Therefore, a conservative outlook has been maintained in accordance with the analysts' expectations.

Mexican economy has behaved with fortitude despite an external complex scenario, mainly due to the growing interest rates in the United States of America and the uncertainty surrounding the North America Free Trade Agreement. The structural changes carried out in the last few years have been a turning point, solving some inefficiencies in the public and education sectors and as well as in the labor market. Within this scenario, the economic growth expectations have been increased, especially for private consumption. This magnitude has been growing around 3% on an annual basis boosted by the labor market with the lowest unemployment rate since 2006. This growth has enabled a tax deficit reduction with a primary surplus close to the figures achieved previous to the crisis. There has been an impact both in the financial markets and in the rating agencies. With respect to the financial markets, the country risk has dropped an average of 50 b.p.s. since 2016 and the volatility of the Mexican pesos exchange rate in 2017 has also been lower. As for the rating agencies, both Fitch and S&P raised their perspectives on Mexico to stable. On the other hand, offsetting the improvements in the macroeconomic scenario, in the telecommunication markets and in the mobile phone market in particular, there is still a great difference between the incumbent operator and the rest its competitors. The share of the incumbent operator is still higher than 65% in the wide bandwidth and cell phone markets in terms of total active accesses despite the change in the sector regulation carried out by the government in order to increase competence and allow the entrance of new operators in the market.

With regard to the United Kingdom, the long-term OIBDA margin for operations (24%) is within the range of the analysts' consensus. With respect to the ratio of CapEx over revenues, over the term of the strategic plan, in United Kingdom the ratio of invest at a percentage of revenue is aligned with analysts' estimations (around 13%). The discount rate (6.3%) is considered to have greater market risk, due to the increase in uncertainty of British equity securities as a result of Brexit, however, this risk is in line with the estimates given by analysts. Accordingly, the currency which is the main variable used for external adjustments because of its great commercial dependence on Europe, has suffered a 4% depreciation against euro since 2016 (comparing year-end to year-end), and therefore a negative impact in the British net assets and cash flows nominated in euros.

In the United Kingdom the perpetuity growth rate is a 1.7% showing a slight slowdown since 2016 caused by the negative effect of the inflation rate growth in the British consumers' purchasing power.

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

8.4. Transactions protected for tax purposes

Transactions carried out in 2017 that qualify for special tax treatment, as defined in Articles 76 and 87, as applicable, of Chapter VII of Title VII of Legislative Royal Decree 27/2014 of November 27 approving the Spanish Corporate Income Tax Law, are detailed in the following paragraphs. Transactions qualified for special tax treatment carried out in prior years are disclosed in the financial statements for those years.

On June 1, 2017, Telefónica de España, S.A.U. approved the merger by absorption of Telefónica Telecomunicaciones Públicas, S.A.U. with the subsequent dissolution of the latter and the transfer en bloc of its assets and liabilities to Telefónica de España, S.A.U. which also acquires all its rights and obligations by universal succession. This merger transaction is governed by the Special Regime of the Chapter VII, Title VII, of Spanish Income Tax Law 27/2014 of November 27.

On July 24, 2017 the deed of the merger between Telefónica International Wholesale Services II, S.L.U. and Telefónica International Wholesale Services, S.L.U. was filed. Telefónica International Wholesale Services, S.L.U. was absorbed and dissolved and its assets and liabilities were transferred en bloc to Telefónica International Wholesale Services II, S.L.U. with effects January 1, 2017. On December 21, 2017 the deed was filed in the Madrid Companies Register. The transaction is governed by the Chapter VIII, Title VII of the Consolidated Spanish Income Tax Law, approved by Legislative Royal Decree 4/2004 on March 5.

On July 27, 2017 the deed of the merger between Telefónica Digital España, S.L.U. and Telefónica Digital Holding, S.L.U. was filed. Telefónica Digital Holding, S.L.U. was absorbed and dissolved and its assets and liabilities were transferred en bloc to Telefónica Digital España, S.L.U. with effects January 1, 2017. On September 14, 2017 the deed was filed in the Madrid Companies Register. The transaction is governed by the Chapter VIII, Title VII of the Consolidated Spanish Income Tax Law, approved by Legislative Royal Decree 4/2004 on March 5.

On September 1, 2017, Telefónica Audiovisual Digital, S.L.U (TAD) completed the merge by absorption of Telefónica Studios, S.L.U. with the subsequent dissolution of the latter and the transfer in bloc of its assets and liabilities to TAD which also acquired all its rights and obligations by universal succession. This merger transaction is governed by the Special Regime of the Chapter VII, Title VII, of Spanish Income Tax Law 27/2014 of November 27.

On September 20, 2017 Telefónica Latinoamérica Holding, S.L. merged and absorbed Ecuador Cellular Holding, S.L.U., y Telefónica Datacorp, S.A.U, with the subsequent dissolution without liquidation of the two latter companies and the transfer of their equity by universal succession. As a result of this transaction, Telefónica Latinoamérica Holding, S.L. increased its equity figure by 1,232 million euros, that is the net book value of the equity of the absorbed subsidiaries. Telefónica, S.A. as sole stakeholder of these two companies recorded at the net book value, 1,278 million euros, the partial disposal of the investment in the companies as well as the capital increase in Telefónica Latinoamérica Holding, S.L. The transaction is governed by the Chapter VIII, Title VII of the Consolidated Spanish Income Tax Law, approved by Legislative Royal Decree 4/2004 on March 5.

Also in 2017 the European trans-border merger between Wayra Investigación y Desarrollo, S.L.U (absorbing company) and Wayra Ireland Limited (absorbed company) was carried out. This transaction was governed by the Trans-border European merger by absorption project with the dissolution without liquidation of the absorbed company and the transfer en bloc of its assets and liabilities as well as the rights and obligations to the absorbing company. The merger is effective on January 1, 2017. The merger agreement was approved on September 25, 2017 by the sole stakeholder of the subsidiary and it is also governed by the Special Regime of the Chapter VII, Title VII, of Spanish Income Tax Law 27/2014 of November 27.

In 2017, Telefónica I+D, S.A.U. (absorbing company) was merged with EyeOS, S.L. (absorbed company). The transaction took place as a merger by absorption, with dissolution without liquidation of the absorbed company and the subsequent transfer en bloc of its assets and liabilities and the acquisition by the absorbing company of the rights and obligations of the absorbed by universal succession. The merger agreement was approved by the sole stakeholder on June 29, 2017 and the deed was filed in Madrid Companies register on October 18, 2017. As stated in the merger agreement, the transaction is governed by he Act of Structural Amendments of private companies 3/2009, article 52.1, of April 3 as both merged companies are owned by the same stakeholder, Telefónica, S.A.

On November 2, 2017, Telefónica de España, S.A.U. carried out the merger by absorption of Iberbanda, S.A.U. with the subsequent dissolution of the latter and the transfer en bloc of its assets and liabilities to Telefónica de España, S.A.U. which also acquired the rights and obligations of Iberbanda by universal succession. The transaction is governed by the Special Regime of the Chapter VII, Title VII, of Spanish Income Tax Law 27/2014 of November 27.

On November 2, 2017, Telefónica Móviles España, S.A.U. carried out the merger by absorption of Tuenti Technologies, S.L.U. (Tuenti) with the subsequent dissolution of the latter and the transfer en bloc of its assets and liabilities to Telefónica Móviles España, S.A.U. which also acquired the rights and obligations of Tuenti by universal succession. The transaction is governed by the Special Regime of the Chapter VII, Title VII, of Spanish Income Tax Law 27/2014 of November 27.

8.5. The breakdown and maturity of loans to Group companies and associates in 2017 and 2016 are follows:

2017

Millions of euros

Company	2018	2019	2020	2021	2022	2022 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	861	—	—	—	—	—	861
Telefónica Móviles México, S.A. de C.V.	—	773	—	—	—	—	773
Telfisa Global, B.V.	733	—	—	—	—	—	733
Telefónica de España, S.A.U.	987	550	—	—	—	—	1,537
Telxius Telecom, S.A.U.	—	—	—	140	280	280	700
Telefónica Latinoamérica Holding, S.L.	484	—	—	—	—	8	492
Other companies	361	23	52	—	15	20	471
Total	**3,426**	**1,346**	**52**	**140**	**295**	**308**	**5,567**

2016

Millions of euros

Company	2017	2018	2019	2020	2021	2022 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	88	400	—	—	—	—	488
Telefónica Móviles México, S.A. de C.V.	—	796	—	—	—	—	796
Telefónica de Contenidos, S.A.U.	386	—	—	—	—	—	386
Telefónica de España, S.A.U.	259	—	550	—	—	—	809
Telxius Telecom, S.A.U.	8	—	—	—	140	560	708
Telefónica Latinoamérica Holding, S.L.	2,099	—	—	—	—	—	2,099
Other companies	327	139	59	176	17	113	831
Total	**3,167**	**1,335**	**609**	**176**	**157**	**673**	**6,117**

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

- The financing extended to Telefónica Móviles España, S.A.U. in 2017 consists of:
  - a loan of 400 million euros, with maturity date in 2018, and signed in 2013 to enable this company to meet its payment obligations. These credits have 1 million euros of accrued interest receivable.
  - dividends distributed and unpaid in December 2017 amounting to 305 million euros.

  Moreover, 155 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (87 million euros in 2016).

- At December 31, 2017 and 2016, the account receivable with Telefónica Móviles México, S.A. de C.V. amounts to 11,697 million Mexican pesos, equivalent to 496 and 538 million euros, respectively. This asset is recognised as non-current pursuant to the expected collection date at the reporting date. At December 31, 2017, accrued interest receivable totals 277 million euros (258 million euros in 2016), which forms part of the non-current balance receivable.

- In December 2017, Telfisa Global, B.V. has distributed dividends totaling 733 million euros which are unpaid as of the date of these Financial Statements.

- The 2017 balance of Telefónica de España, S.A.U. consists of:
  - a 550 million euro credit facility granted and drawn down in full in November 2014 and maturing in 2019.
  - dividends distributed and upaid in 2017 amounting to 664 million euros.
  - Additionally, there is also a balance of 323 million euros comprising tax receivables from the subsidiary for its tax expense declared in the consolidated tax return (93 million euros in 2016) and accrued interest of 1 million euros.

    The credit facility of 165 million euros drawn in 2016 was cancelled in 2017 on its maturity date.

- On May 27, 2016, with the aim of enabling the necessary funds for restructuring the infrastructure business line of the Group as described at the beginning of this Note, the Company granted its subsidiary Telxius Telecom, S.A.U. with a credit of 560 million euros at a fix interest rate and maturity in 2026 and a credit of 140 million euros and an interest rate referred to euribor maturing 2021.

- As of December 31, 2016 the balance of unpaid dividends from Telefónica Latinoamérica Holding, S.L. amounted to 2,041 million euros. In 2017 1,650 million euros have been received, and therefore the remaining due amount is 391 million euros.

  Moreover, 101 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (58 million euros in 2016).

- At December 31, 2016, the account receivable with Telefónica de Contenidos, S.A.U. consisted of a 340 million euros participating loan awarded in 2013 and maturity date in May 2016 that was extended until May 2017 with the same principal amount and conditions, all of which has been drawn down. At maturity date the loan was cancelled and no outstanding amount related to this loan remains unpaid as of the date of these financial statements.

  In addition, in 2016 46 million euros of taxes were receivable from this subsidiary for its tax expense declared in the consolidated tax return (no amounts are outstanding for this concept in 2017).

- In 2016, under ¨Other companies¨ it was included a long term tax receivable with Telefónica Emisiones, S.A.U. amounting to 96 million euros due to the limitation of the deductibles financial expenses (calculated in the tax group). In 2017 this concept has been cancelled.

The Company has also extended 686 million euros (446 million euros in 2016) of loans in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17). The most significant amounts have already been disclosed through this Note. All these amounts fall due in the short term.

Disposals of current loans to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A.'s tax group totaling 446 million euros (597 million euros in 2016).

Total accrued interest receivable at December 31, 2017 and 2016 included under "Current loans to group companies and associates" amount to 2 million euros.

8.6. Other financial assets with Group companies and associates

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

Note 9. Financial investments

9.1. The breakdown of “Financial investments” at December 31, 2017 and 2016 is as follows:

2017

	Assets at fair value							Assets at amortized cost					
					Measurement hierarchy								
Millions of euros	Available-for-sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on observable market data	Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal assets at fair value	Total carrying amount	Total fair value
Non-current financial investments	**340**	**1,087**	**1,422**	**2,849**	**340**	**2,509**	**—**	**—**	**912**	**912**	**902**	**3,761**	**3,751**
Equity instruments	340	—	—	340	340	—	—	—	—	—	—	340	340
Derivatives (Note 16)	—	1,087	1,422	2,509	—	2,509	—	—	—	—	—	2,509	2,509
Loans to third parties and other financial assets	—	—	—	—	—	—	—	—	912	912	902	912	902
Current financial investments	**—**	**132**	**661**	**793**	**—**	**793**	**—**	**759**	**5**	**764**	**764**	**1,557**	**1,557**
Loans to third parties	—	—	—	—	—	—	—	759	5	764	764	764	764
Derivatives (Note 16)	—	132	661	793	—	793	—	—	—	—	—	793	793
Total financial investments	**340**	**1,219**	**2,083**	**3,642**	**340**	**3,302**	**—**	**759**	**917**	**1,676**	**1,666**	**5,318**	**5,308**

2016

Millions of euros	Assets at fair value				Measurement hierarchy			Assets at amortized cost					
	Available-for-sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on observable market data	Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal assets at fair value	Total carrying amount	Total fair value
Non-current financial investments	**339**	**1,757**	**2,910**	**5,006**	**339**	**4,667**	**—**	**—**	**10**	**10**	**10**	**5,016**	**5,016**
Equity instruments	339	—	—	339	339	—	—	—	—	—	—	339	339
Derivatives (Note 16)	—	1,757	2,910	4,667	—	4,667	—	—	—	—	—	4,667	4,667
Loans to third parties and other financial assets	—	—	—	—	—	—	—	—	10	10	10	10	10
Current financial investments	**—**	**716**	**936**	**1,652**	**—**	**1,652**	**—**	**42**	**248**	**290**	**290**	**1,942**	**1,716**
Loans to third parties	—	—	—	—	—	—	—	42	248	290	290	290	64
Derivatives (Note 16)	—	716	936	1,652	—	1,652	—	—	—	—	—	1,652	1,652
Total financial investments	**339**	**2,473**	**3,846**	**6,658**	**339**	**6,319**	**—**	**42**	**258**	**300**	**300**	**6,958**	**6,732**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market. Additionally, on this valuation, the credit valuation adjustment or CVA net for counterparty (CVA + DVA), which is the methodology used to measure the credit risk of the counterparties and of Telefónica itself is calculated to adjust the fair value determination of the derivatives. This adjustment reflects the possibility of insolvency or deterioration of the credit quality of the counterparty and Telefónica.

9.2 Held-for-trading financial assets and hedges

These two categories include the fair value of outstanding derivative financial instruments at December 31, 2017 and 2016 (see Note 16).

9.3 Available-for-sale financial assets.

This category mainly includes the fair value of investments in listed companies (equity instruments) over which the Company does not have significant control or influence. The movement of items composing this category at December 31, 2017 and 2016 are as follows:

December 31, 2017

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	283	—	—	—	30	313
Promotora de Informaciones, S.A. (PRISA)	56	—	(30)	—	1	27
Total	**339**	**—**	**(30)**	**—**	**31**	**340**

December 31, 2016

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	298	—	—	(9)	(6)	283
Other companies	86	35	(68)	—	3	56
Total	**384**	**35**	**(68)**	**(9)**	**(3)**	**339**

In accordance with the change introduced in 2017 by the article 21 of Income Tax Law 27/2014 with respect to the non-deductible nature of the net losses generated by the sale of some investments with certain characteristics, the Company is not accruing the tax impacts of the fair value adjustments in its available-for-sale investments.

Banco Bilbao Vizcaya Argentaria, S.A.

The impacts shown in the column “Fair value adjustments” on both years include the fair value adjustment of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). These impacts are registered in the Equity of the Company (Note 11.2.). The effect recorded in 2016 under "other movements", relates to the sale of rights to scrip dividends that the bank distributed.

At December 31, 2017 Telefónica, S.A.'s investment in BBVA represents 0.66% of that company's share capital.

Promotora de Informaciones, S.A. (Prisa)

In 2017 a write down of the investment in Prisa amounting to 30 million euros has been recorded under the caption of "Losses on available-for-sale investments" caption.

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2017 and 2016 is as follows:

Millions of euros	2017	2016
Other non-current financial assets:		
Investment properties	10	10
Collateral guarantees	902	—
Other current financial assets:		
Loans to third parties	759	42
Other current financial assets	5	248
Total	**1,676**	**300**

"Other current financial assets" included in 2016 240 million euros of the collateral funds reinvested in BBVA (see Notes 12 and 20). This concept has been reclassified as a non-current asset in 2017 in accordance with the underlying derivative instruments which it relates to.

9.4.1 Loans to third parties

In 2017 Telefónica, S.A. has opened bank deposit contracts with a maturity period between 3 and 12 months totaling 700 million euros. This caption also included third party option premium which are due and are still unpaid amounting to 57 million euros, as well as the outstanding interest revenues of 2 million euros.

In June 2015, when the sale of the shares of Telecom Italia, S.p.A. was completed, Telefónica arranged several hedging instruments which would allow Telefónica to repurchase the shares of Telecom Italia, S.p.A. that were necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia S.p.A. (see Note 13). This "Equity Swap" contract envisaged a premium for Telefónica, S.A. that was quarterly cashed until the contract vesting in 2017. After the vesting of the bonds detailed in Note 13 of these Financial Statements the asset has also been cancelled (41 million euros as current asset at December 31, 2016).

Note 10. Trade and other receivables

The breakdown of “Trade and other receivables” at December 31, 2017 and 2016 is as follows:

Millions of euros	2017	2016
Trade receivables	1	3
Trade receivables from Group companies and associates	263	247
Other receivables	—	16
Employee benefits receivable	1	—
Tax receivables (Note 17)	310	181
Total	**575**	**447**

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

“Trade receivables” and “Trade receivables from Group companies and associates” in 2017 and 2016 include balances in foreign currency equivalent to 100 million and 117 million euros, respectively.

In 2017 these amounts relate to receivables in US dollars and Venezuelan bolivars. The balance in Venezuelan bolivars has arisen in 2017 by the change in the brand fee contract, which is being invoiced in that currency since March 31, 2017.

In 2016 these amounts were entirely related to receivables in US dollars.

These balances give rise to exchange rate losses in the income statement of 15 million euros in 2017 (3 million euros of exchange rate losses in 2016).

Note 11. Equity

11.1 Capital and reserves

a) Share capital

2017

On September 20, 2017, the public deed evidencing the conversion of bonds, share capital increase and amortization of bonds was registered, on which were issued 154,326,696 new ordinary shares, of a nominal value of 1 euro each, within the framework of the conversion of the bonds mandatorily convertible into shares of Telefónica, S.A. that were issued by its wholly owned subsidiary, Telefónica Participaciones, S.A.U. on September 24, 2014, guaranteed by Telefónica, S.A. As a result of the aforementioned conversion and the referred capital increase, the share capital of Telefónica, S.A. was set at 5,192,131,686 euros, divided into 5,192,131,686 ordinary shares of the same class and series, with a nominal value of 1 euro each of them.

At December 31, 2017, Telefónica, S.A.´s share capital amounted to 5,192,131,686 euros and consisted of 5,192,131,686 fully paid ordinary shares of a single series, par value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system ("Continuous Market"), where they form part of the "Ibex 35" Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through American Depositary Shares ('ADSs').

2016

On October 11, 2016, the deed of a share capital decrease was registered, cancelling 74,627,988 of own shares, reducing the company´s share capital by 74,627,988 euros.

On December 7, 2016, the deed of a share capital increase of 137,233,781 euros ordinary shares with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 5,037,804,990 euros subsequent to this increase.

Authorizations by Shareholders' Meeting

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

Pursuant to the aforementioned authorizations, as of December 2017, the Board of Directors is empowered to increase the share capital up to the maximum nominal amount of 2,469,208,757 euros.

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

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

At December 31, 2017 and 2016, Telefónica, S.A. held the following treasury shares:

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/31/17	65,687,859	10.48	8.13	534	1.26514%
Treasury shares at 12/31/16	141,229,134	10.48	8.82	1,246	2.80339%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A.during the years 2017 and 2016 is as follows:

	Number of shares
Treasury shares at 12/31/15	**141,639,159**
Acquisitions	77,087,297
Employee share option plan (see Note 19.3)	(2,869,334)
Share redemption	(74,627,988)
Treasury shares at 12/31/16	**141,229,134**
Employee share option plan (see Note 19.3)	(3,518,795)
Other movements	(72,022,480)
Treasury shares at 12/31/17	**65,687,859**

Acquisitions

There have been no acquisitions of treasury shares in 2017 (668 million euros in 2016).

Share redemption and disposals

In 2017 there has been no share redemption or disposals of treasury shares.

On October 13, 2016, pursuant to the resolution of the share capital reduction, by the cancellation of own shares, adopted by the Annual General Shareholders' Meeting of Telefónica held on May 12, 2016, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (Registro Mercantil). Therefore, 74,627,988 of the own shares of Telefónica, S.A. totaling 813 million euros were cancelled.

Employee share option plan

Treasury shares sold, including share plans redemptions, in 2017 and 2016 amount to 37 million euros and 26 million euros, respectively.

On July 31, 2017 the third phase of the Global Employee Share Plan ("the GESP") matured and 3,187,055 treasury shares were delivered to Group employees who met the established requirements.

On September 30, 2017 the first phase of the "Performance and Investment Plan 2014-2017" ("PIP 2014-2017") and the first phase of the "Talent for the Future Share Plan" (TFSP1) ended. No shares have been delivered to Telefónica Group executives or managers (see Note 19).

On June 30, 2016 the third phase of the Telefónica, S.A. long-term incentive plan called "Performance and Investment Plan 2013-2016" ("PIP 2013-2016") ended. No shares were delivered to Telefónica Group Management.

Other movements

On March 14, 2017 Telefónica entered into a swap agreement with Koninklijke KPN NV (hereinafter, KPN) to deliver 72 million of its treasury shares in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter. On the same date, this stake was sold at the same price to Telefónica Germany Holdings, GMBH so that, at 2017 year end, Telefónica, S.A. has no direct participation in Telefónica Deutschland Holding AG and the transfer of the stake has not had impact in the income statement.

The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 35.2 million of Telefónica shares in 2017 and 2016, recognized in both years under "Current interest-bearing debt" in the accompanying balance sheet.

b) Legal reserve

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2016 the balance of this reserve amounted to 985 million euros. The General Shareholders' Meeting held on June 9, 2017 approved the allocation of 2 million euros with a charge to the profit of exercise 2016. At December 31, 2017, after the capital increase carried forward in 2017, the Company needs to increase the legal reserve by 51 million euros until the legal reserve is fully constituted. The proposed appropriation of profit in 2017 includes an allocation of that amount.

c) Other reserves

"Other reserves" includes:

- The "Revaluation reserve" which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2017 and 2016, an amount of 6 and 8 million euros, respectively, corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to "Other reserves". The balance of this reserve at December 31, 2017 and 2016 was 78 million euros and 85 million euros, respectively.

- Reserve for cancelled share capital: In accordance with Section 335.c) of the Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. In 2016 new reserves for share redemption capital amounting to 74 million euros were created. In 2017, no additional amount has been recorded. The cumulative amount of the reserve for cancelled share capital at December 31, 2017 and 2016 totals 731 million euros.

- Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company set aside a non-distributable reserve of 2 million euros for goodwill amortization. Pursuant to the provisions of Royal Decree 602/2016 of December 2, 2016, the goodwill amortization as of January 1, 2015, amounting to 10 million euros was registered with a counterparty in this reserve.

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

d) Dividends

Dividend distribution in 2017

Approval was given at the General Shareholders Meeting of June 9, 2017 to pay a gross dividend of 0.40 for each company share issued, in circulation and carrying entitlement to this distribution against unrestricted reserves, payable in two tranches. The first payment of a gross amount of 0.20 in cash per share was made on June 16, 2017 amounting to 994 million euros and the second payment of a gross amount of 0.20 in cash per share was made on December 14, 2017 amounting to 1,025 million euros.

Dividend distribution in 2016

Approval was given at the Shareholder´s Meeting of Telefónica S.A. of May 12, 2016 to pay a dividend with a charge to unrestricted reserves of a fixed gross 0.40 euros per outstanding share carrying dividend rights. The dividend was paid in full on May 19, 2016, and the total amount paid was 1,906 million euros.

On November 11, 2016 the Executive Commission of Telefónica, S.A.’s Board of Directors approval to pay a scrip dividend amounting to approximately 0.35 per share consisting of the assignment of free allotment rights with an irrevocable purchase commitment by the Company, and a subsequent capital increase with a charge to reserves by such amount as may be determined pursuant to the terms and conditions of the resolution, by means of the issue of new ordinary shares having a par value of one euro, to fulfill said allotments. The payment was made on December 7, 2016, with and impact in equity amounting to 500 million euros.

The shareholders of 70.01% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Thus, the final number of shares issued in the capital increase was 137,233,781 shares with a nominal value of 1 euro each.

e) Other equity instruments

On September 24, 2014, Telefónica Participaciones, S.A.U., issued 1,500 million euros of bonds necessarily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. The notes could be converted at the option of the noteholders or the issuer. On the same date, Telefónica, S.A. issued bonds with the same amount and characteristics of the previously detailed bond and a derivative instrument (warrant) in order to hedge the conversion price of the bonds. These bonds were wholly acquired by Telefónica Participaciones, S.A.U.

At the issuance date, in the balance sheet of Telefónica, S.A. the present value of the coupons was recorded as debt, the warrant was accounted as long term liabilities to group companies and the remaining amount of 1,206 million euros was recorded as “other net equity instruments”.

As explained in section a) of this same Note, at maturity of the notes, Telefónica, S.A. on behalf of Telefónica Participaciones, S.A.U. delivered a total of 154,341,669 shares of Telefónica S.A. at a conversion price of 9.7174 euros per share (minimum conversion price after the standard adjustments included in the terms of the notes).

In order to meet the conversion of the notes, Telefónica S.A. issued 154,326,696 new shares in execution of a capital increase and delivered 14,973 treasury shares.

11.2 Unrealized gains (losses) reserve

The movements in the items composing "Unrealized gains (losses) reserve" in 2017 and 2016 are as follows:

2017

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	8	2	2	30	—	42
Cash flow hedges (Note 16)	(674)	(191)	48	161	(41)	(697)
Total	**(666)**	**(189)**	**50**	**191**	**(41)**	**(655)**

2016

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	11	13	(3)	(17)	4	8
Cash flow hedges (Note 16)	(801)	477	(119)	(308)	77	(674)
Total	**(790)**	**490**	**(122)**	**(325)**	**81**	**(666)**

Note 12. Financial liabilities

The breakdown of “Financial liabilities” at December 31, 2017 and 2016 is as follows:

2017

	LIABILITIES AT FAIR VALUE						LIABILITIES AT AMORTIZED COST			
				MEASUREMENT HIERARCHY						
Millions of euros	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data	Trade and other payables	Trade and other payables at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
Non-current financial liabilities	**1,038**	**1,758**	**2,796**	**—**	**2,796**	**—**	**45,160**	**48,409**	**47,956**	**51,205**
Payable to Group companies and associates	—	—	—	—	—	—	40,642	43,821	40,642	43,821
Bank borrowings	—	—	—	—	—	—	4,186	4,244	4,186	4,244
Derivatives (Note 16)	1,038	1,758	2,796	—	2,796	—	—	—	2,796	2,796
Other financial liabilities	—	—	—	—	—	—	332	344	332	344
Current financial liabilities	**119**	**133**	**252**	**—**	**252**	**—**	**15,201**	**15,226**	**15,453**	**15,478**
Payable to Group companies and associates	—	—	—	—	—	—	14,101	14,128	14,101	14,128
Bank borrowings	—	—	—	—	—	—	896	894	896	894
Bonds and other marketable debt securities	—	—	—	—	—	—	204	204	204	204
Derivatives (Note 16)	119	133	252	—	252	—	—	—	252	252
Total financial liabilities	**1,157**	**1,891**	**3,048**	**—**	**3,048**	**—**	**60,361**	**63,635**	**63,409**	**66,683**

2016

Millions of euros	LIABILITIES AT FAIR VALUE						LIABILITIES AT AMORTIZED COST			
				MEASUREMENT HIERARCHY						
	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data	Trade and other payables	Trade and other payables at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
Non-current financial liabilities	**1,721**	**963**	**2,684**	**—**	**2,684**	**—**	**41,839**	**45,248**	**44,523**	**47,932**
Payable to Group companies and associates	—	—	—	—	—	—	37,274	40,680	37,274	40,680
Bank borrowings	—	—	—	—	—	—	4,427	4,430	4,427	4,430
Derivatives (Note 16)	—	963	2,684	—	2,684	—	—	—	2,684	2,684
Other financial liabilities	—	—	—	—	—	—	138	138	138	138
Current financial liabilities	**628**	**51**	**679**	**—**	**679**	**—**	**16,179**	**16,274**	**16,858**	**16,953**
Payable to Group companies and associates	—	—	—	—	—	—	13,146	13,233	13,146	13,233
Bank borrowings	—	—	—	—	—	—	1,635	1,637	1,635	1,637
Bonds and other marketable debt securities	—	—	—	—	—	—	1,158	1,164	1,158	1,164
Derivatives (Note 16)	628	51	679	—	679	—	—	—	679	679
Other financial liabilities	—	—	—	—	—	—	240	240	240	240
Total financial liabilities	**2,349**	**1,014**	**3,363**	**—**	**3,363**	**—**	**58,018**	**61,522**	**61,381**	**64,885**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market. Additionally, on this valuation, the credit valuation adjustment or CVA net for counterparty (CVA + DVA), which is the methodology used to measure the credit risk of the counterparties and of Telefónica itself is calculated to adjust the fair value determination of the derivatives. This adjustment reflects the possibility of insolvency or deterioration of the credit quality of the counterparty and Telefónica.

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

The entire amount of "Other financial liabilities" in 2016 was related to the received deposit of 240 million as collateral guarantees with BBVA (see Note 9 and 20). In 2017 this concept is posted as non-current according to the dues of the financial derivatives which it relates to.

Note 13. Bonds and other marketable debt securities

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2017 and 2016 are as follows:

2017

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	**788**	**370**	**1,158**
Additions	—	428	428
Disposals	(774)	(594)	(1,368)
Revaluation and other movements	(14)	—	(14)
Closing balance	**—**	**204**	**204**
Details of maturities:			
Non-current	—	—	—
Current	—	204	204

2016

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	**820**	**65**	**885**
Additions	—	374	374
Disposals	—	(69)	(69)
Revaluation and other movements	(32)	—	(32)
Closing balance	**788**	**370**	**1,158**
Details of maturities:			
Non-current	—	—	—
Current	788	370	1,158

The balance of “Non-convertible debentures and bonds” in 2016 was referred to Telefónica’s bond issuance made on July 24, 2014 amounting to 750 million euros. The bonds were mandatorily exchangeable into ordinary shares of Telecom Italia, S.p.A, maturing on July 24, 2017.

At the maturity date, on July 24, 2017, the Company has fulfilled its commitments to deliver the shares with the vesting of the equity swap instrument arranged for that purpose (see Note 9.4). This movement is shown as disposals in the 2017 chart of movements.

Under ¨Revaluation and other movements¨ in 2016 the payment of the coupon for that issuance amounting to 45 million euros was included.

At December 31, 2017 there are no debentures and bonds outstanding. Maturities of the nominal amounts of debenture and bond issues at December 31, 2016 were as follows:

2016

Millions of euros			Maturity						
Name	**Interest rate**	**% interest rate**	**2017**	**2018**	**2019**	**2020**	**2021**	**Subsequent years**	**TOTAL**
DEBENTURES AND BONDS:									
Bonds exchangeable into Telecom Italia shares	FIXED	6.00%	750	—	—	—	—	—	750
Total issues			**750**	—	—	—	—	—	**750**

13.2 At December 31, 2017, Telefónica, S.A. had a corporate promissory note programme registered with the CNMV, with the following features:

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

At December 31, 2017 the outstanding balance on this promissory note programme is 204 million euros (370 million euros in 2016).

13.3 The average interest rate during 2017 on debentures and bonds outstanding during the year was 6.17% (6.01% in 2016) and the average interest rate on corporate promissory notes was -0.090% (0.045% in 2016).

Note 14. Interest-bearing debt and derivatives

14.1 The balances at December 31, 2017 and 2016 are as follows:

December 31, 2017

Millions of euros	Current	Non-current	Total
Loans with financial entities (Note 12)	896	4,186	5,082
Derivative financial liabilities (Note 16)	252	2,796	3,048
Total	**1,148**	**6,982**	**8,130**

December 31, 2016

Millions of euros	Current	Non-current	Total
Loans with financial entities (Note 12)	1,635	4,427	6,062
Derivative financial liabilities (Note 16)	679	2,684	3,363
Total	**2,314**	**7,111**	**9,425**

14.2 The nominal values of the main interest-bearing debts at December 31, 2017 and 2016 are as follows:

2017

Description	Value Date	Maturity Date	Currency	Limit 12/31/17 (millions)	Balance (million of euros)
Structured Financing (*)	05/03/11	07/30/21	USD	153	128
Structured Financing (*)	02/22/13	01/31/23	USD	551	460
Structured Financing (*)	08/01/13	10/31/23	USD	446	371
Bilateral (1)	06/26/14	06/26/19	EUR	1,500	1,500
Structured Financing (*)	12/11/15	03/11/26	USD	679	566
Structured Financing (*)	12/11/15	03/11/26	EUR	469	423
Bilateral loan	02/23/16	02/23/21	EUR	100	100
Loan	03/08/16	03/08/21	EUR	300	300
Bilateral loan	10/24/16	03/19/19	EUR	150	150
Credit	03/27/13	03/14/20	EUR	200	167
Credit	12/27/02	12/27/18	EUR	380	292

(1) On January 17, 2017 an amendment was made to the bilateral loan, with an outstanding amount of 1,500 million euros, split into two tranches with a new amortization schedule: tranche A for 500 million euros maturing on June 26, 2017 and tranche B for 1,000 million euros maturing on June 26, 2019. Later, on February 17, 2017 a new amendment was signed extending the maturity of the tranche A for 500 million euros up to June 26, 2019. Facility with amortization schedule.

(*) Facility with amortization schedule, showing in the column "Limit 12/31/17" the undrawn amount.

2016

Description	Value Date	Maturity Date		Limit Currency (millions)	December 31, 2017	Balance (million of euros)
Structured financing(*)	5/3/2011	7/30/2021		USD	200	190
Structured financing (*)	2/22/2013	1/31/2023		USD	669	635
Structured financing (*)	8/1/2013	10/31/2023		USD	532	505
Syndicated facility (1)	2/18/2014	2/18/2021	(1)	EUR	3,000	—
Bilateral	6/26/2014	6/26/2018	(2)	EUR	1,500	1,500
Syndicated facility (2)	2/19/2015	2/19/2022	(3)	EUR	2,500	550
Bilateral	6/30/2015	6/30/2020		EUR	200	200
Syndicated facility (3)	11/17/2015	2/15/2019		EUR	1,500	—
Structured financing (*)	12/11/2015	3/11/2026		USD	737	324
Structured financing (*)	12/11/2015	3/11/2026		EUR	492	240
Bilateral loan	2/23/2016	2/23/2019		EUR	100	100
Bilateral loan	2/23/2016	2/23/2021		EUR	100	100
Loan	3/8/2016	3/8/2021		EUR	300	300
Bilateral loan	10/24/2016	3/19/2019		EUR	300	300

(*) Facilities with amortization schedule.
(1) Extended for 12 additional months of the syndicated facility signed in February 2014.
(2) Extended for 12 additional months of the syndicated facility signed in February 2015
(3) On November 15, 2016 an amendment was signed extending the maturity for 12 additional months of the syndicated facility and an early repayment of 1,500 million euros was made.

14.3 Maturities of balances at December 31, 2017 and 2016 are as follows:

December 31, 2017	Maturity						
Millions of euros	2018	2019	2020	2021	2022	Subsequent years	Closing balance
Loans with financial entities	896	1,799	461	540	322	1,064	5,082
Derivative financial liabilities (Note 16)	252	209	820	440	174	1,153	3,048
Total	**1,148**	**2,008**	**1,281**	**980**	**496**	**2,217**	**8,130**

December 31, 2016	Maturity						
Millions of euros	2017	2018	2019	2020	2021	Subsequent years	Closing balance
Loans with financial entities	1,635	1,159	702	380	965	1,221	6,062
Derivative financial liabilities (Note 16)	679	298	348	1,003	515	519	3,363
Total	**2,314**	**1,457**	**1,050**	**1,383**	**1,480**	**1,740**	**9,425**

14.4 Interest-bearing debt arranged or repaid in 2017 mainly includes the following:

Description	Limit 12/31/17 (millions)	Currency	Outstanding balance 12/31/2017 (million euros)	Arrangement date	Maturity date	Drawdown 2017 (million euros)	Repayment 2017 (million euros)
Syndicated facility	2,500	EUR	—	02/19/15	02/19/22	—	(550)
Structured financing (*)	679	USD	566	12/11/15	03/11/26	329	(48)
Structured financing (*)	469	EUR	423	12/11/15	03/11/26	217	(34)
Structured financing (1)(*)	—	EUR	—	06/13/14	12/15/17	—	(185)
Bilateral loan (2)	—	EUR	—	02/23/16	02/23/17	—	(100)
Bilateral loan (3)	—	EUR	—	11/13/15	05/16/17	—	(100)
Bilateral loan (4)	1,500	EUR	1,500	06/26/14	06/26/19	—	—
Bilateral loan (5)	—	EUR	—	06/30/15	12/29/17	—	(200)
Bilateral loan (6)	150	EUR	150	10/24/16	03/19/19	—	(150)
Credit facility	380	EUR	292	12/27/02	12/27/20	292	—
Credit facility	200	EUR	167	03/27/13	03/14/20	167	—

(1) On December 15, 2017 an early repayment was made for the long-term financing originally scheduled to mature in 2019.
(2) On February 23, 2017 an early cancellation was made for the bilateral loan originally scheduled to mature in 2019.
(3) On May 16, 2017 an early cancellation was made for the bilateral loan originally scheduled to mature in 2020.
(4) On January 17, 2017 an amendment was made to the bilateral loan, with an outstanding amount of 1,500 million euros, split into two tranches with a new amortization schedule: tranche A for 500 million euros maturing on June 26, 2017 and tranche B for 1,000 million euros maturing on June 26, 2019. Later, on February 17, 2017 a new amendment was signed extending the maturity of the tranche A for 500 million euros up to June 26, 2019.
(5) On December 29, 2017 an early repayment was made for the 200 million euros bilateral loan originally scheduled to mature in 2020.
(6)On December 19, 2017 an early repayment was made for 150 million euros of the 300 million euros bilateral loan originally scheduled to mature in 2019.
(*) Facility with amortization schedule, showing in the column "Limit 12/31/17" the undrawn amount.

On March 30, 2017 an early cancellation was made for the 1,500 million euros syndicated credit facility (undrawndown at the cancellation date) originally scheduled to mature in 2019.

14.5 Average interest on loans and borrowings

The average interest rate in 2017 on loans and borrowings denominated in euros was 0.47% (0.566% in 2016) and 2.516% (2.066% in 2016) for foreign-currency loans and receivables.

14.6 Unused credit facilities

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

At December 31, 2017 and 2016, Telefónica had undrawn credit facilities amounting to 9,967 million euros and 10,302 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2017 and 2016 is not subject to compliance with financial ratios (covenants).

Note 15. Payable to group companies and associates

15.1 The breakdown of payable to group companies and associates at the 2017 and 2016 year ends is as follows:

December 31, 2017

Millions of euros	Non-current	Current	Total
Loans	40,610	13,569	54,179
Trade payables to Group companies and associates	—	264	264
Derivatives (Note 16)	3	6	9
Payable to subsidiaries due to taxation on a consolidated basis	29	262	291
Total	**40,642**	**14,101**	**54,743**

December 31, 2016

Millions of euros	Non-current	Current	Total
Loans	37,218	12,365	49,583
Trade payables to Group companies and associates	6	239	245
Derivatives (Note 16)	18	202	220
Payable to subsidiaries due to taxation on a consolidated basis	32	340	372
Total	**37,274**	**13,146**	**50,420**

The maturity of these loans at the 2017 and 2016 year ends is as follows (figures in millions of euros):

December 31, 2017

Company	2018	2019	2020	2021	2022	2023 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	4,248	3,491	4,632	3,389	3,641	15,454	34,856
Telefónica Europe, B.V.	2,052	849	1,421	622	995	5,538	11,476
Telfisa Global, B.V.	7,269	—	—	—	—	—	7,269
Telefónica Participaciones, S.A.U.	—	—	—	—	—	578	578
Total	**13,569**	**4,340**	**6,053**	**4,011**	**4,636**	**21,570**	**54,179**

December 31, 2016

Company	2017	2018	2019	2020	2021	2022 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	5,901	3,902	3,467	4,853	3,588	13,031	34,742
Telefónica Europe, B.V.	2,814	1,121	848	1,445	621	3,771	10,620
Telfisa Global, B.V.	3,577	—	—	—	—	—	3,577
Telefónica Participaciones, S.A.U.	73	—	—	—	571	—	644
Total	**12,365**	**5,023**	**4,315**	**6,298**	**4,780**	**16,802**	**49,583**

Financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2017 amounting 11,476 million euros (10,620 million euros in 2016). This financing entails a number of loans paying market interest rates calculated on a Euribor plus spread basis, with an average interest rate in 2017 of 4.55% (4.20% in 2016). The main source of this financing was the funds obtained through the issuance of undated deeply subordinated reset rate guaranteed securities amounting to 7,026 million euros (6,052 million euros in 2016), bonds and debentures amounting to 1,542 million euros (1,686 million euros in 2016) and commercial paper amounting to 1,850 million euros (2,630 million euros in 2016).

Financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2017 was 34,856 million euros (34,742 million euros in 2016). This financing is arranged as loans in between these companies on the similar terms and conditions as those of the notes issued under the debt issuance programmes of Telefónica Emisiones, S.A.U. The average interest rate in 2017 was 3.86% (4.26% in 2016). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2017 by tapping the European, American and Taiwanese capital markets, issuing bonds totaling 7,324 million euros (4,900 million euros in 2017).

The characteristics of the main bonds issued during 2017 are the following:

Description	Issue date	Maturity date	Amount in millions (nominal)	Currency of issue	Amount in millions of euros (nominal)	Coupon
Telefónica Emisiones, S.A.U.						
EMTN bond	1/17/2017	1/17/2025	1,250	EUR	1,250	1.528%
EMTN bond	1/17/2017	10/17/2028	500	EUR	500	2.318%
EMTN bond	1/25/2017	1/25/2019	150	EUR	150	EURIBOR 3M + 0.40%
SHELF Bond	3/8/2017	3/8/2027	1,500	USD	1,251	4.103%
SHELF Bond	3/8/2017	3/8/2047	2,000	USD	1,667	5.213%
EMTN bond (retap)	3/17/2017	10/17/2028	200	EUR	200	2.318%
EMTN bond	4/18/2017	4/18/2037	200	USD	167	4.9%
SHELF bond (retap)	4/28/2017	3/8/2047	500	USD	417	5.213%
EMTN bond	9/12/2017	1/12/2028	1,250	EUR	1,250	1.715%

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes restatements to amortized cost at December 31, 2017 and 2016 as a result of fair value interest rate and exchange rate hedges.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States, Europe and since 2016, Spain. The balance payable to this subsidiary is formalized through several Deposit Agreements accruing interest at market rates and amounting to 7,269 million euros in 2017 (3,577 million euros in 2016).

Financing raised by Telefónica, S.A. through Telefónica Participaciones, S.A.U. at December 31, 2017 totals 578 million euros (644 million euros in 2016). The 2017 financing corresponds to these two concepts:

- A loan with a principal of 600 million euros at an annual interest rate of 0.25%; which funds are a result of the issuance of non-dilutive convertible bonds carried out by Telefónica Participaciones, S.A.U., guaranteed by Telefónica, S.A. at March 9, 2016. These bonds are benchmarked against the value of Telefónica S.A. shares, with an aggregate nominal amount of 600 million euros, an issue price of 101.25% and 5-year maturity.

- The actual value of the interests from a bond issuance launched on September 24, 2014 by Telefónica, S.A. and fully subscribed by Telefónica Participaciones, S.A.U., 3-year maturity and an annual coupon of 4.90%. These bond issuance has been matured and cancelled during 2017 (see Note 11). There is no value pending to pay at December 31, 2017, for this second concept.

15.2 The balance of "Payable to subsidiaries due to taxation on a consolidated basis" was 291 million euros and 372 million euros at December 31, 2017 and 2016, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax losses) to the tax group headed by Telefónica, S.A. (see Note 17). The current- or non-current classification is based on the Company's projection of maturities.

The main amounts here correspond to Telefónica Latinoamérica Holding, S.L. for 39 million euros (228 million in 2016), Telefónica Digital España, S.L.U. for 34 million euros (26 million in 2016) and to Latin American Cellular Holing S.L. for 168 million euros.

Note 16. Derivative financial instruments and risk management policies

a) Derivative financial instruments

During 2017, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2017, the total outstanding balance of derivatives transactions was 116,580 million euros (126,938 million euros in 2016), of which 92,948 million euros related to interest rate risk and 23,632 million euros to foreign currency risk. In 2016, 105,303 million euros related to interest rate risk and 21,635 million euros to foreign currency risk.

It should be noted that at December 31, 2017, Telefónica, S.A. had transactions with financial institutions to hedge exchange rate risk for other Telefónica Group companies amounting to 1,637 million euros (1,739 million euros in 2016). At year-end 2017 and 2016, the Company had no transactions to hedge interest rate risk for other Group companies. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

The breakdown of Telefónica, S.A.'s interest rate and exchange rate derivatives at December 31, 2017, their notional amounts at year end and the expected maturity schedule is as follows:

2017

Millions of euros

Type of risk	Value in Euros	Telefónica receives Carrying	Telefónica receives Currency	Telefónica pays Carrying	Telefónica pays Currency
Euro interest rate swaps	**67,355**				
Fixed to fixed	390	390	EUR	390	EUR
Fixed to floating	34,020	34,020	EUR	34,020	EUR
Floating to fixed	32,945	32,945	EUR	32,945	EUR
Foreign currency interest rate swaps	**23,523**				
Fixed to floating					
CHFCHF	534	625	CHF	625	CHF
GBPGBP	3,865	3,430	GBP	3,430	GBP
JPYJPY	74	10,000	JPY	10,000	JPY
USDUSD	17,026	20,421	USD	20,421	USD
Floating to fixed					
GBPGBP	1,217	1,080	GBP	1,080	GBP
USDUSD	807	968	USD	968	USD
Exchange rate swaps	**16,040**				
Fixed to fixed					
EURBRL	138	138	EUR	546	BRL
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to fixed					
USDEUR	702	765	USD	702	EUR
Floating to floating					
CHFEUR	515	625	CHF	515	EUR
GBPEUR	2,048	1,600	GBP	2,048	EUR
JPYEUR	101	10,000	JPY	101	EUR
USDEUR	12,441	14,849	USD	12,441	EUR
Forwards	**7,592**				
BRLEUR	9	33	BRL	9	EUR
CLPEUR	1	640	CLP	1	EUR
CZKEUR	67	1,708	CZK	67	EUR
EURBRL	728	728	EUR	2,889	BRL
EURCLP	367	367	EUR	270,421	CLP
EURGBP	3,056	3,056	EUR	2,712	GBP
EURMXN	1	1	EUR	18	MXN
EURUSD	1,269	1,269	EUR	1,522	USD
GBPEUR	1,021	906	GBP	1,021	EUR
GBPUSD	1	1	GBP	1	USD
USDBRL	20	24	USD	77	BRL
USDCLP	3	4	USD	2,353	CLP

USDCOP	1	1	USD	4,130	COP
USDEUR	1,018	1,216	USD	1,018	EUR
USDGBP	28	33	USD	25	GBP
USDPEN	2	3	USD	9	PEN
Swaption	**425**				
Fixed to floating					
EUREUR	205	205	EUR	205	EUR
Floating to fixed					
EUREUR	220	220	EUR	220	EUR
Subtotal	**114,935**				

Millions of euros

Notional amounts of structured products with options	Value in euros	Notional	Currency
Interest rate options Caps & Floors	**1,645**		
Caps&Floors	**1,645**		
GBP	845	750	GBP
EUR	800	800	EUR
Currency options	**—**		
USDEUR	120	120	EUR
EURUSD	(120)	(120)	EUR
Subtotal	**1,645**		
TOTAL	**116,580**		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Promissory notes	**200**	**—**	**200**	**—**	**—**
Pension Plans	**5,009**	**700**	**1,145**	**935**	**2,229**
Loans	**21,041**	**4,158**	**7,838**	**4,525**	**4,520**
in national currency	14,635	2,425	6,600	1,660	3,950
in foreign currencies	6,406	1,733	1,238	2,865	570
Debentures and bonds MtM	**63,822**	**7,696**	**18,311**	**13,470**	**24,345**
in national currency	18,767	2,200	8,250	2,917	5,400
in foreign currencies	45,055	5,496	10,061	10,553	18,945
Other underlying*	**26,508**	**13,851**	**5,647**	**3,030**	**3,980**
CCS	390	73	317	—	—
Forward	7,591	7,591	—	—	—
IRS	18,527	6,187	5,330	3,030	3,980
Total	**116,580**	**26,405**	**33,141**	**21,960**	**35,074**

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries

The breakdown of Telefónica, S.A.'s derivatives in 2016, their notional amounts at year end and the expected maturity schedule is as follows:

2016

Millions of euros		Telefónica receives		Telefónica pays	
Type of risk	**Value in Euros**	**Carrying**	**Currency**	**Carrying**	**Currency**
Euro interest rate swaps	**79,252**				
Fixed to fixed	265	265	EUR	265	EUR
Fixed to floating	44,866	44,899	EUR	44,866	EUR
Floating to fixed	34,121	34,121	EUR	34,121	EUR
Foreign currency interest rate swaps	**23,939**				
Fixed to floating					
CHFCHF	582	625	CHF	625	CHF
CZKCZK	194	5,250	CZK	5,250	CZK
GBPGBP	4,203	3,595	GBP	3,595	GBP
JPYJPY	81	10,000	JPY	10,000	JPY
USDUSD	15,469	16,304	USD	16,304	USD
Floating to fixed					
CZKCZK	46	1,250	CZK	1,250	CZK
GBPGBP	1,391	1,190	GBP	1,190	GBP
USDUSD	1,973	2,079	USD	2,079	USD
Exchange rate swaps	**11,836**				
Fixed to fixed					
EURBRL	159	163	EUR	546	BRL
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to floating					
CHFEUR	515	625	CHF	515	EUR
GBPEUR	2,048	1,600	GBP	2,048	EUR
JPYEUR	101	10,000	JPY	101	EUR
USDEUR	8,918	11,417	USD	8,918	EUR
Forwards	**7,526**				
BRLEUR	56	203	BRL	(56)	EUR
CLPEUR	1	840	CLP	(1)	EUR
CZKEUR	47	1,250	CZK	(46)	EUR
EURBRL	573	573	EUR	(1,969)	BRL
EURCLP	208	208	EUR	(146,800)	CLP
EURGBP	2,614	2,614	EUR	(2,236)	GBP
EURMXN	1	1	EUR	(21)	MXN
EURUSD	1,849	1,849	EUR	(1,949)	USD
GBPEUR	1,011	860	GBP	(1,011)	EUR
GBPUSD	3	3	GBP	(3)	USD
USDBRL	22	22	USD	(76)	BRL

USDCLP	4	4	USD	(2,824)	CLP
USDCOP	3	4	USD	(10,691)	COP
USDEUR	1,113	1,182	USD	(1,113)	EUR
USDGBP	19	21	USD	(17)	GBP
USDPEN	2	2	USD	(8)	PEN
Swaption	**435**				
Fixed to floating					
EUREUR	205	205	EUR	205	EUR
Floating to fixed					
EUREUR	230	230	EUR	230	EUR
Subtotal	**122,988**				

Millions of euros

Notional amounts of structured products with options	Value in Euros	Notional	Currency
Interest rate options Caps & Floors	**1,677**		
Caps&Floors	**1,677**		
GBP	877	750	GBP
EUR	800	800	EUR
Currency options	**2,273**		
USDEUR	1,558	1,558	EUR
EURUSD	715	715	EUR
Subtotal	**3,950**		
TOTAL	**126,938**		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Promissory notes and Commercial Paper	**1,460**	**160**	**50**	**1,250**	**—**
Pension plans	**5,160**	**375**	**1,155**	**955**	**2,675**
Loans	**30,939**	**3,024**	**8,761**	**7,477**	**11,677**
in national currency	20,310	1,625	5,400	5,360	7,925
in foreign currencies	10,629	1,399	3,361	2,117	3,752
Debentures and bonds MtM	**59,074**	**10,363**	**14,298**	**26,531**	**7,882**
in national currency	26,800	8,550	7,750	9,000	1,500
in foreign currencies	32,274	1,813	6,548	17,531	6,382
Other underlying*	**30,305**	**16,255**	**5,467**	**3,265**	**5,318**
CCS	1,237	910	77	250	—
Currency options	2,470	2,470	—	—	—
Forward	6,721	6,721	—	—	—
IRS	19,877	6,154	5,390	3,015	5,318
Total	**126,938**	**30,177**	**29,731**	**39,478**	**27,552**

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries

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

The fair value of Telefónica, S.A derivatives portfolio with external counterparties at December 31, 2017 was equivalent to a net asset of 254 million euros (net asset of 2,956 million euros in 2016).

b) Risk management policy

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

The main market risks affecting Telefónica are as follows:

Exchange rate risk

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

Interest rate risk

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

Share price risk

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

Other risks

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

Credit risk appears when a counterparty fails to meet or delays its payment obligations in accordance with the agreed terms, driving an impairment in an asset due to: (i) solvency issues, or (ii) no intention to pay.

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

Risk management

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

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

Exchange rate risk

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

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

At December 31, 2017, the net financial debt in pounds sterling was approximately 1.97 times the value of the business' OIBDA in 2017 for Group companies in the United Kingdom, which is in line with the target of twice that of previous years. At December 31, 2017, the net financial debt denominated in pounds sterling was equivalent to 3,089 million euros, which is more than the 2,828 million euros at December 31, 2016.

Telefónica also manages its exchange rate risk, seeking to significantly reduce the negative impact of any currency exposure on the income statement, both from transactions recognized on the balance sheet and those classified as highly probable, regardless of whether or not open positions are held. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in obtaining funding in the local currency, making it impossible to arrange a low-cost hedge (as in Argentina and Venezuela); financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for funding through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high depreciation risks.

The main transactions that generate or may generate exchange rate risk (regardless of whether or not they have an impact on the income statement) are, among others, as follows: issues in currencies other than the euro, which is Telefónica S.A.'s functional currency, highly probable transactions in other currencies, future cash inflows in other currencies, investments and divestments, provisions for collections or payments in foreign currency, the actual value of the investments (subsidiaries) in currencies other than the euro.

Interest rate risk

The Telefónica´s financial expenses are exposed to changes in interest rates. In 2017 Euribor, the dollar Libor and the pound sterling Libor were the short term rates that accounted for most of the exposure. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest rate options.

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

To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2017 has been assumed, as well as a 100 basis point decrease in all currencies in order to avoid negative rates. The constant position equivalent to that prevailing at the end of the year has also been assumed.

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2017 was assumed, as well as a 100 basis point decrease in all currencies and terms. Cash flow hedge positions were also considered as they are the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

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

	Impact on Consolidated net income	Impact on P/L Telefónica, S.A.	Impact on Consolidated Equity	Impact on Telefónica, S.A. Equity
+100bp	(91)	(22)	335	365
-100bp	74	4	(331)	(365)

Share price risk

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

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

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

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2017 to cover shares deliverable under the PIP. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

Liquidity risk

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

1. The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.

2. The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (drawing upon firm credit lines arranged with banks), assuming budget projections are met.

Country risk

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

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,

2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Credit risk

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

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

When managing credit risk, Telefonica considers the use of CDS, novations, derivatives with break clauses and signing CSA´s under certain conditions.

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

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

The Telefónica Group considers customer credit risk management as a key element to achieve its business and customer base growth targets in a sustainable way. This management approach relies on the active evaluation of the risk-reward balance within the commercial operations and on the adequate separation between the risk ownership and risk management functions.

Formal delegation of authority procedures and management practices are implemented in the different Group companies, taking into account benchmark risk management techniques but adapted to the local characteristics of each market. Commercial debtors that may cause a relevant impact on the Telefónica Group consolidated financial statements and increased risk profile products - due to customer target, term, channels or other commercial characteristics - are subject to specific management practices in order to mitigate the exposure to credit risk.

This customer credit risk management model is embedded in the day-to-day operational processes of the different companies, where the credit risk assessment guides both the product and services available for the different customers and the collection strategy.

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

Capital management

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

The corporate finance department estimates the cost of capital on a continuous basis through the monitoring of the financial markets and the application of standard industry approaches for calculating weighted average cost of capital, or WACC, so that it can be applied in the valuation of businesses in course and in the evaluation of investment projects. Telefónica also uses as reference a net financial debt (excluding items of a non-recurring or exceptional nature) that allows for a comfortable investment grade credit rating as assigned by credit rating agencies, aiming at protecting credit solvency and making it compatible with alternative uses of cash flow that could arise at any time.

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

Derivatives Policy

Telefónica's derivatives policy emphasizes the following points:

- Derivatives based on a clearly identified underlying.
- Matching of the underlying to one side of the derivative.

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

Hedge accounting

Hedges can be of three types:

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

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

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

In 2017 the Company recognized a loss of 6.28 million euros for the ineffective part of cash flow hedges (a profit of 1.19 million euros in 2016).

The fair value of Telefónica, S.A. derivatives with third parties amounted to a positive MTM (accounts receivable) of 254 million euros in 2017 (2,956 million euros in 2016).

The fair value of Telefónica, S.A. intragroup derivatives amounted to a positive MTM (accounts receivable) of +1 million euros in 2017 (-190 million euros in 2016).

The breakdown of the Company's derivatives with counterparties not belonging to the Telefónica Group at December 31, 2017 and 2016 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

2017

Millions of euros		Notional amount maturities (*)				
Derivatives	**Fair value (**)**	**2018**	**2019**	**2020**	**Subsequent years**	**Total**
Interest rate hedges	**(159)**	**(1,407)**	**(780)**	**1,690**	**577**	**80**
Cash flow hedges	246	(900)	(650)	1,523	1,844	1,817
Fair value hedges	(405)	(507)	(130)	167	(1,267)	(1,737)
Exchange rate hedges	**341**	**1,266**	**621**	**2,219**	**4,720**	**8,826**
Cash flow hedges	341	1,266	621	2,219	4,720	8,826
Fair value hedges	—	—	—	—	—	—
Interest and exchange rate hedges	**(389)**	**308**	**962**	**800**	**3,744**	**5,814**
Cash flow hedges	(389)	308	962	800	3,744	5,814
Fair value hedges	—	—	—	—	—	—
Net investment Hedges	**16**	**(2,168)**	**—**	**—**	**—**	**(2,168)**
Other derivatives	**(63)**	**(3,418)**	**1,766**	**(495)**	**(3,401)**	**(5,548)**
Interest rate	(123)	(3,035)	1,840	(495)	(3,401)	(5,091)
Exchange rate	(9)	(1,193)	(74)	—	—	(1,267)
Other	69	810	—	—	—	810

(*) For interest rate hedges, the positive amount is in terms of fixed “payment.” For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.
(**) Positive amounts indicate payables.

2016

Millions of euros		Notional amount maturities (*)				
Derivatives	**Fair value (**)**	**2017**	**2018**	**2019**	**Subsequent years**	**Total**
Interest rate hedges	**(229)**	**(334)**	**(396)**	**(667)**	**383**	**(1,014)**
Cash flow hedges	323	(240)	150	(500)	2,950	2,360
Fair value hedges	(552)	(94)	(546)	(167)	(2,567)	(3,374)
Exchange rate hedges	**(1,094)**	**(955)**	**1,137**	**323**	**2,760**	**3,265**
Cash flow hedges	(1,063)	834	1,170	359	2,760	5,123
Fair value hedges	(31)	(1,789)	(33)	(36)	—	(1,858)
Interest and exchange rate hedges	**(1,507)**	**111**	**367**	**1,187**	**4,527**	**6,192**
Cash flow hedges	(1,507)	111	367	1,187	4,527	6,192
Other derivatives	**(126)**	**1,819**	**(331)**	**(437)**	**(3,052)**	**(2,001)**
Interest rate	(5)	1,232	(471)	(456)	(3,168)	(2,863)
Exchange rate	(84)	—	140	19	116	275
Other	(37)	587	—	—	—	587

(*) For interest rate hedges, the positive amount is in terms of fixed “payment.” For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.
(**) Positive amounts indicate payables.

Note 17. Income tax

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2017 and 2016 comprised 45 and 58 companies, respectively.

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

Tax balances as of December 31, 2017 and 2016 are as follows:

Millions of euros	2017	2016
Tax receivables:	**3,167**	**3,144**
Deferred tax assets:	**2,857**	**2,963**
Deferred income tax (income)	406	479
Long-term tax credits for loss carryforwards	1,060	1,174
Unused tax deductions	1,391	1,310
Current tax receivables (Note 10):	**310**	**181**
Withholdings	19	14
Corporate income tax payable	284	152
VAT and Canary Islands general indirect tax refundable	7	15
Tax payable:	**680**	**645**
Deferred tax liabilities:	**427**	**571**
Current payables to public administrations (Note 18):	**253**	**74**
Personnel income tax withholdings	4	6
Withholding on investment income, VAT and other	247	66
Social security	2	2

Telefónica, S.A. has tax credits for loss carryforwards, unused by Tax Group in Spain at December 31, 2017 amounting to 8,346 million euros (gross):

2017/12/31	Total carryforwards	Less than 1 year	More than 1 year	Total recognized
Tax Group tax credits for loss carryforwards	**8,095**	237	7,858	**4,240**
Prior to Tax Group loss carryforwards (*)	**251**	—	251	—

(*) Unused tax credits for loss carryforwards

Total tax credits based on the taxable income recognized in the balance sheet at December 31, 2017 therefore amounts to 1,060 million euros (1,174 million euros in 2016).

During 2017, Telefónica, S.A., as head of the Telefónica tax group, made payments on account of income tax amounting to 131 million euros (150 million euros in 2016).

17.1 Movement in deferred tax assets and liabilities

The balances and movements in "Deferred tax assets" and "Deferred tax liabilities" for Telefónica, S.A. at December 31, 2017 and 2016 are as follows:

2017

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	**1,174**	**479**	**1,310**	**2,963**	**571**
Arising in the year	—	19	9	28	—
Reversal	(114)	(56)	(6)	(176)	(2)
Transfers to the tax group's net position	—	(36)	78	42	(142)
Closing balance	**1,060**	**406**	**1,391**	**2,857**	**427**

2016

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	**2,077**	**3,444**	**632**	**6,153**	**88**
Arising in the year	—	95	639	734	—
Reversal	(866)	(3,705)	—	(4,571)	(25)
Transfers to the tax group's net position	(37)	645	39	647	508
Closing balance	**1,174**	**479**	**1,310**	**2,963**	**571**

In 2016 and as a consequence of the amendment of the Corporate Tax Law by Royal Legislative Decree (RLD) 3/2016, of December 2, reversals of active temporary differences due to the value adjustments of its investments in shares were recorded totaling 1,541 million euros.

Furthermore, and due to the aforementioned legislative change that limits the offsetting of negative tax bases 25%, as a result of the impairment testing on the recoverability of deferred tax assets carried out by the Group, tax loss carryforwards amounting to 866 million euros were derecognized.

In 2017 and after the completion of the future recoverability testing of tax loss carryforwards in a 10-year scenario, 98 million euros of tax loss carryforwards have been reversed.

As a result of the aforementioned analysis in 2017, tax deductions of 9 million euros were capitalized (639 million euros in 2016).

In 2016, transfers between temporary differences, deferred tax assets and liabilities in Telefónica, S.A. were mainly related to the accounting of the gross amount of deferred taxes in connection with the impairment losses of investments of 675 million euros.

The effect of deferred taxes in equity in 2017 is a net addition of 5 million euros (net disposal of 42 million euros in 2016).

On the other hand, and in compliance with the sixteenth transitional provision of this RDL 3/2016, which requires the inclusion of one-fifth of the investment portfolio impairment losses which had been deductible in the tax base before 1 January 2013, 141 million euros of recorded deferred tax liabilities have been reversed, recorded in full in these financial statements (166 million euros in 2016).

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

The calculation of the income tax expense and income tax payable for 2017 and 2016 is as follows.

Millions of euros	2017	2016
Accounting profit before tax	**274**	**2,866**
Permanent differences	(2,241)	(5,654)
Temporary differences:	394	875
Arising in the year	32	352
Arising in prior years	362	523
Tax result	**(1,573)**	**(1,913)**
Gross tax payable	(393)	(478)
Corporate income tax refundable	**(393)**	**(478)**
Capitalization losses carry forward/write down deductions	89	227
Temporary differences for tax valuation	(99)	3,409
Other effects	84	(336)
Corporate income tax accrued in Spain	(319)	2,822
Foreign taxes	39	20
Income tax	**(280)**	**2,842**
Current income tax	(355)	(458)
Deferred income tax	75	3,300

The permanent differences mainly correspond to the change in the accounting write-off of the investments in Telefónica Group companies, to the non-tributable dividends received, to the non-tributable capital gains on the sale of 40% share capital of Telxius Telecom, S.A.U. (see Note 8) and to the financial goodwill.

The heading "Activation/reversion: negative tax bases and/or deductions" includes the effect of the activation of tax credits by deductions amounting to 9 million euros (639 million euros in 2016) and the reversal of tax credits by negative tax bases of 98 million euros (866 million euros) as a result of the analysis of recoverability indicated above.

The caption “Other effects” mainly includes the impact arising from the provision made in relation to the tax deductibility of the financial goodwill taken in the year (see section 17.3),

In addition, as explained in Note 22 of Telefónica, S.A.’s 2016 financial statements, the Group had decided to accrue the amount of the goodwill amortized on a tax basis corresponding to the purchase of the O2 Group companies subject to the sale agreement. Since the sale transaction was finally not executed, the aforementioned provision was reversed in 2016.

17.3 Tax inspections and tax-related lawsuits

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

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

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

In June 2017 the Company received an order of the Audiencia Nacional extending the effects of its ruling from February 27, 2014 from another tax payer to the individual legal status of Telefónica in connection with the "Juros sobre el capital propio" (interest on own capital). As a consequence of the aforementioned, the Audiencia Nacional has voided the corporate income tax assesment, for the years 2005 to 2007 and 2008 to 2011 related to "Juros sobre el capital propio" settled by the tax authorities.

With respect to the use of tax loss carryforwards in the years subject to settlement during the inspection 2008 to 2011, still under litigation, in November 2017 the Company brought a judicial appeal to the Audiencia Nacional, against the alleged dismissal of the claim in the absence of a reply from the authorities.

At 2017 year end, it is not expected that there is any need to recognize additional liabilities for the outcome of these litigations.

Tax deducibility of financial goodwill (Article 12.5)

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

The Company, under this standard, has been amortizing for tax purposes the financial goodwill from its investments, both direct and indirect, in O2, BellSouth and Coltel (prior to December 21, 2007) and Vivo (acquired in 2010). The positive accumulated tax effect in the corresponding settlements of Corporate Income Tax from 2004 to the closing of December 31, 2017, was 1,226 million euros.

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

However, at the issuance date of these annual accounts the three decisions are pending of final ruling: the first two have been annulled by two Judgments of the General Court of the European Union and they have been appealed by the Commission in the Court of Justice of the European Union and sent again to the General Court in a sentence ruled on December 21, 2016 so that the court reviews again the nature of this tax deduction, and the third is still pending a judgment at first instance. Furthermore, there are doubts in the Spanish courts regarding the classification of the incentive as a deduction and its maintenance in the case of subsequent transmission.

The Company has decided to carry on setting up a provision of the amount relating to the goodwill amortized for tax purposes corresponding to the purchase of Vivo, for a total of 215 million euros as of December 31, 2017 (147 million euros as of December 31, 2016). The amount relating to the companies of the O2 Group was reversed in 2016 after the European Commission made public its decision to prohibit the sale transaction of Telefónica UK.

Note 18. Trade, other payables and provisions

A) Trade and other payables

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

Millions of euros	2017	2016
Suppliers	84	110
Accounts payable to personnel	36	42
Other payables	166	260
Other payables to public administrations (Note 17)	253	74
Total	**539**	**486**

Other payables

In accordance with Telefónica's irrevocable commitment, undertaken in 2015, to pay a 325 million euros donation to Fundación Telefónica, in 2017 cash payments have been made in an amount of 91 million euros. The outstanding amount of this item as of December 31, 2017 totals 145 million euros.

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

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

	2017	2016
	Number of days	Number of days
Weighted average maturity period	**37**	**27**
Ratio of payments	38	27
Ratio of outstanding invoices	19	25

	Millions of euros	Millions of euros
Total Payments	323	313
Outstanding invoices	28	38

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree 4/2013, amending Law 3/2004, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers, as contractually agreed with them, in 2017 included payment periods of up to 60 days.

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

Payments to Spanish suppliers in 2017 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the delay in the billing process (a legal obligation for the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

B) Provisions

In 2017 and 2016 the concepts and amounts under the provision captions are the following:

2017

Millions of euros	Non-current	Current	Total
Tax Provisions	230	—	230
Termination plans (Note 19)	115	44	159
Other provisions	114	79	193
Total	**459**	**123**	**582**

2016

Millions of euros	Non-current	Current	Total
Tax Provisions	162	—	162
Negative net book value of investments (Note 8)	22	—	22
Termination plans (Note 19)	140	44	184
Other provisions	43	77	120
Total	**367**	**121**	**488**

Movements in the provisions during 2017 and 2016 are disclosed below:

Millions of euros	2017	2016
Opening balance:	**488**	**878**
Additions	142	278
Amortization and reversals	(29)	(520)
Transfers	(22)	(163)
Fair value adjustments and others	3	15
Closing balance:	**582**	**488**
Maturity:		
Non-current	459	367
Current	123	121

The caption “additions” includes in 2017 the 62 million euros of tax provisions for the article 12.5 of the Spanish Corporate Tax Law related to the acquisition of Vivo (see Note 17).

In respect of the sale of Telefónica Europe, plc, in 2015 an accrual of 377 million euros was registered relating to the tax deduction of goodwill amortization of the company. In 2016, after the European Commission decided not to authorise this transaction, that amount was reversed (see Note 17).

Under “transfers” it is shown the negative book value of certain investments in group companies and associates (see Note 8). During 2017, there was a partial recovery of the value of the investments and, therefore, this concept totals -22 million euros (-163 million euros in 2016).

With respect to the simplification and transformation process of the Telefónica Group, Telefónica, S.A. launched in 2015 a voluntary termination plan ending in December 2017 for the employees who met the requirements defined by the Plan regarding age and seniority in the Company, among others. Following this transformation and simplification framework, the Company has, on the one hand, extended the plan termination till 2018 and on the other hand, has set up in December 2016 a new voluntary programme aimed at some employees who met certain requirements related to seniority in the Company. In 2017 the last programme has been extended, with an additional provision of 11 million euros shown as Additions in the 2017 chart of movements (128 millions in 2016).

During 2017 amortization and reversals related to this plan have been recorded amounting to 36 million euros.

Note 19. Revenue and expenses

19.1 Revenue

a) Rendering of services

Telefónica, S.A. has contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2017 and 2016, “Rendering of services to Group companies and associates” included 481 million euros and 460 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., O2 Holdings, Ltd., Telefónica Latinoamérica Holding, S.L. and, this last year, also to Telxius Telecom, S.A.U. Revenue received for this concept in 2017 and 2016 amounted to 31 million euros and 36 million euros, respectively, recognized under “Rendering of services to Group companies and associates”.

Revenues also include property rental income amounting to 45 and 44 million euros in 2017 and 2016, respectively, mainly from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

b) Dividends from Group companies and associates

The detail of the main amounts recognized in 2017 and 2016 is as follows:

Millions of euros	2017	2016
Telfisa Global, B.V.	733	—
Telefónica de España, S.A.U.	664	—
Telefónica Europe, plc.	619	623
Telefónica Móviles España, S.A.U.	305	373
Telefônica Brasil, S.A.	355	266
Sao Paulo Telecomunicaçoes, Ltda	130	73
Telefónica Móviles Argentina, S.A.	164	—
Telefónica Centroamérica Inversiones, S.L.	34	42
Telefónica International Wholesale Services, S.L.	—	484
Other companies	23	67
Total	**3,027**	**1,928**

c) Interest income on loans to Group companies and associates

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

Millions of euros	2017	2016
Telefónica Móviles México, S.A. de C.V.	43	40
Telefónica de España, S.A.U.	7	9
Telefónica Latinoamérica Holding, S.L. (previously Telefónica Internacional, S.A.U.)	—	29
Telefónica Móviles Argentina, S.A.	4	11
Telefónica Participaciones, S.A.U.	15	24
Other companies	26	62
Total	**95**	**175**

19.2 Non-core and other current operating revenues

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

19.3 Personnel expenses and employee benefits

The breakdown of "Personnel expenses" is as follows:

Millions of euros	2017	2016
Wages, salaries and other personnel expenses	151	281
Pension plans	2	13
Social security costs	21	16
Total	**174**	**310**

In 2017, "Wages, salaries and other personnel expenses" includes 11 million euros of compensations payable during the year (115 million euros in 2016). The outstanding figure of this concept at 2017 closing balance has been described in Note 18.

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

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

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

At December 31, 2017, 2,059 employees had signed up for the plan (2,043 employees in 2016). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in

Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 4 million euros in 2017 (5 million euros in 2016).

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

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 8 million euros in both 2016 and 2017. In 2017 some executives under this Pension Plan for Senior Executives have left the Company, and accordingly their accumulated contributions have been retrieved by Telefónica, S.A. and registered as a minor expense totaling 9 million euros.

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

The main share-based payment plans in place in the 2016-2017 period are as follows:

Long-term incentive plan based on Telefónica, S.A. shares: "Performance and Investment Plan 2011-2016"

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

Under this plan, a certain number of shares of Telefónica, S.A. were delivered to plan participants selected by the Company who decided to participate on compliance with stated requirements and conditions.

The plan lasted five years and was divided into three independent phases.

The third and final phase expired on June 30, 2016. The maximum number of shares assigned to this phase of the plan was 7,020,473 shares assigned on July 1, 2013, with a fair value of 6.40 euros per share. Delivery of shares was not required at the end of the phase according to the general conditions of the plan; therefore, managers did not receive any shares.

Long-term incentive plan based on Telefónica, S.A. shares: "Performance and Investment Plan 2014-2019"

The Telefónica, S.A. General Shareholders' Meeting on May 30, 2014 approved a new instalment of the long-term share-based incentive "Performance and Investment Plan" for certain senior executives and members of the Group's management team, operational on completion of the first "Performance and Investment Plan".

Like its predecessor, the term of the new plan is a total of five years divided into three phases. The initial and the second share allocations took place on October 1, 2014, and on October 1, 2015, respectively. Regarding the third phase of this 2016-2019 Plan, the Company's Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

The first phase expired on September 30, 2017. The maximum number of shares assigned to this phase of the plan was 6,927,953 shares assigned on October 1, 2014, with a fair value of 6.82 euros per share. Delivery of shares was not required at the end of the phase according to the general conditions of the plan; therefore managers did not receive any shares.

With regard to the second phase of this plan, the maximum number of shares allocated (including the amount of co-investment) and the number of shares outstanding at December 31, 2017 are set out below:

	No. of shares assigned	No. of shares assigned at 12/31/17	Unit fair value	End date
2nd phase October 1, 2015	6,775,445	5,021,426	6.46	September 30, 2018

Out of the total figure of shares assigned at 12/31/2017, 2,110,472 shares correspond to employees of Telefónica, S.A.

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

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

Under this Plan, a certain number of shares of Telefónica, S.A. will be delivered to participants selected by the Company who have opted to take part in the scheme and meet the requirements and conditions stipulated to this end.

The term of the plan is five years and it is divided into three phases. The initial and the second share allocations took place on October 1, 2014, and on October 1, 2015, respectively. Regarding the third phase of this 2016-2019 Plan, the Company's Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

The first phase expired on September 30, 2017. The maximum number of shares assigned to this phase of the plan was 556,795 shares assigned on October 1, 2014, with a fair value of 6.82 euros per share. Delivery of shares was not required at the end of the phase according to the general conditions of the plan.

The maximum number of shares assigned and the number of shares outstanding at December 31, 2017 is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/17	Unit fair value	End date
2nd phase October 1, 2015	618,000	553,500	6.46	September 30, 2018

Out of the total figure of shares assigned at 12/31/2017, 60,500 shares correspond to employees of Telefónica, S.A.

Telefónica, S.A. global share plan: "Global Employee Share Plan" III (2015-2017)

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

The acquisition period commenced in July 2015 and ended in June 2016. The share holding period ended in August 2017. 27018 employees on the scheme were rewarded with a total of 3,187,055 Telefónica shares, valued at approximately 33 million euros at the time they were delivered.

19.4 Average number of employees in 2017 and 2016 and number of employees at year-end:

2017

	Employees at 12/31/17			Average no. of employees		
Professional category	Female	Males	Total	Female	Males	Total
Chairman and General Managers	—	1	1	—	1	1
Directors	53	125	178	60	130	190
Managers	145	151	296	141	151	292
Project Managers	155	112	267	159	113	272
University graduates and experts	145	92	237	136	85	221
Administration, clerks, advisors	106	6	112	104	6	110
Total	**604**	**487**	**1,091**	**600**	**486**	**1,086**

2016

	Employees at 12/31/17			Average no. of employees		
Professional category	Female	Males	Total	Female	Males	Total
Chairman and General Managers	—	1	1	—	1	1
Directors	65	151	216	62	143	205
Managers	145	156	301	147	162	309
Project Managers	173	116	289	169	117	286
University graduates and experts	134	85	219	123	74	197
Administration, clerks, advisors	106	3	109	116	4	120
Total	**623**	**512**	**1,135**	**617**	**501**	**1,118**

According to the new requirement of the Spanish Companies Law established in article 260, the average number of employees in 2017 with disability of 33% or higher, establishing the categories to which they belong are the following:

Professional category	Number of disabled
Project Managers	1
University graduates and experts	2
Administration, clerks, advisors	1
Total	**4**

19.5 External services.

The items composing “External services” are as follows:

Millions of euros	2017	2016
Rent	12	11
Independent professional services	128	187
Donations (Note 18)	1	1
Marketing and advertising	138	121
Other expenses	121	41
Total	**400**	**361**

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

Future minimum rentals payable under non-cancellable operating leases without penalization at December 31, 2017 and 2016 are as follows:

Millions of euros	Total	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Future minimum rentals 2017	30	5	15	10	—
Future minimum rentals 2016	35	1	10	10	14

19.6 Finance revenue

The items composing "Finance revenue" are as follows:

Millions of euros	2017	2016
Dividends from other companies	14	4
Other third parties financial revenues and gains on derivative instruments	397	918
Total	**411**	**922**

It is included under "other finance revenue" the impacts on the result of the financial hedges arranged to unwind positions for 2017 and 2016, which have the same amount under ¨*Finance costs payable to third parties by financial hedges*¨ and therefore do not have a real effect in the income statement.

19.7 Finance costs

The breakdown of "Finance costs" is as follows:

Millions of euros	2017	2016
Interest on borrowings from Group companies and associates	1,894	1,862
Finance costs payable to third parties and losses on interest rates of financial hedges	405	1,134
Total	**2,299**	**2,996**

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

Millions of euros	2017	2016
Telefónica Europe, B.V.	479	452
Telefónica Emisiones, S.A.U.	1,335	1,337
Other companies	80	73
Total	**1,894**	**1,862**

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

The amount included as "Finance costs payable to third parties and gain (losses) on interest rate of financial hedges" refers to fair value effects in the valuation of derivative instruments described in Note 16. As has been explained in the Note 19.6, some of these derivative instruments do not have a real impact in the income statement because they are part of the hedges to unwind positions so they have a similar impact under ¨other financial revenues¨.

19.8 Exchange differences:

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

Millions of euros	2017	2016
On current operations	33	40
On loans and borrowings	299	472
On derivatives	1,007	1,070
On other items	29	81
Total	**1,368**	**1,663**

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

Millions of euros	2017	2016
On current operations	28	53
On loans and borrowings	88	106
On derivatives	1,013	1,640
On other items	54	34
Total	**1,183**	**1,833**

The change in exchange gains and losses is basically due to the fluctuations in the main currencies the Company works with. In 2017 US dollar exchange rate has depreciated by 13.8% against euro, unlike 2016 trend. Pound sterling exchange rate has depreciated by 3.77% (in 2016 there was also a depreciation of 14% against euro). Brazilian real has depreciated by 15.5% against euro, whereas in 2016 it was significantly strengthened by 24% against euro. These impacts are offset by the hedges contracted to mitigate exchange rate fluctuations.

19.9 Impairment losses on disposal of financial instruments with third parties

In 2017 the Company has recognised a write-down of its investment in Prisa (see Note 9.3) amounting to 30 million euros.

In 2016, it was included under ¨Other Companies¨ gains of 17 million euros due to the sale of the available for sale assets disclosed in Note 9.

Note 20. Other information

a) Financial guarantees

At December 31, 2017, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 45,220 million euros (45,448 million euros at December 31, 2016). These guarantees are measured as indicated in Note 4.g).

Millions of euros

Nominal Amount	2017	2016
Debentures and bonds and equity instruments	42,659	40,596
Loans and other payables	711	2,222
Other marketable debt securities	1,850	2,630
Total	**45,220**	**45,448**

The debentures, bonds and equity instruments in circulation at December 31, 2017 issued by Telefónica Emisiones, S.A.U., Telefónica Europe, B.V., Telefónica Finanzas México, S.A. de C.V. and Telefónica Participaciones, S.A.U., were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 42,659 million euros at December 31, 2017 (40,596 million euros at December 31, 2016). During 2017, Telefónica Emisiones, S.A.U. issued debt instruments on capital markets for an equivalent of 6,852 million euros (4,900 million euros in 2016) and 5,372 million euros matured during 2017 (6,540 million euros during 2016).

The main loans and other debts guaranteed by Telefónica, S.A. at December 31, 2017 are: the cash-settled equity link bonds non-dilutive issued by Telefónica Participaciones, S.A.U., whose outstanding amount at December 31, 2017 was 600 million euros (2,100 million euros at December 31, 2016). During 2017, the notes mandatorily convertible into new and/or existing shares of Telefónica, S.A., issued in 2014 by Telefónica Participaciones, S.A.U. for a total amount of 1,500 million euros, matured.

"Other marketable debt securities" includes the guarantee of Telefónica, S.A. relating to the commercial paper issue program of Telefónica Europe, B.V. The outstanding balance of commercial paper in circulation issued through this programme at December 31, 2017 was 1,850 million euros (2,630 million euros at December 31, 2016).

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2017, these guarantees amounted to approximately 41 million euros (39 million euros at December 31, 2016).

b) Litigation

Telefónica and its group companies are party to several legal proceedings which are currently in progress in the courts of law and the arbitration bodies of the various countries in which we are present.

Based on the advice of our legal counsel it is reasonable to assume that these legal proceedings will not materially affect the financial condition or solvency of the Telefónica Group.

The following unresolved legal proceedings or those underway in 2017 are highlighted (see Note 17 for details of tax-related cases):

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

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

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

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

A hearing was held on May 19, 2015, at the European Union General Court.

On June 28, 2016, the European Union General Court ruled. Although it declares the existence of an infringement of competition law, it annuls Article 2 of the contested Decision and requires the EC to reassess the amount of the fine imposed. The General Court considers that the EC has not neutralized the allegations and evidences provided by Telefónica on services in which there was not potential competition or were outside the scope of Clause Nine.

Telefónica understands that there are grounds for believing that the ruling does not suit at law; consequently, it filed an appeal to the Court of Justice of the European Union, on September 11, 2016.

On November 23, 2016, the EC filed its response against the Telefónica´s appeal. On January 30, 2017, Telefónica filed its reply. On March 9, 2017, the European Commission filed its rejoinder.

On December 13, 2017, the General Court dismissed the appeal filed by Telefónica. In the coming months the European Commission must issue a new resolution in accordance with the judgment of the General Court of June 2016, which urged the Commission to recalculate the amount of the fine.

Decision by the High Court regarding the acquisition by Telefónica of shares in Český Telecom by way of tender offer

Venten Management Limited ("Venten") and Lexburg Enterprises Limited ("Lexburg"), were minority shareholders of Cesky Telecom. In September 2005 both companies sold their shares to Telefónica in a mandatory tender offer. Subsequently Venten and Lexburg, in 2006 and 2009, respectively, filed actions against Telefónica claiming a higher price than the price for which they sold their shares in the mandatory tender offer.

On August 5, 2016, the hearing before the High Court in Prague took place in order to decide the appeal against the second decision of the Municipal Court, which had been favourable to Telefónica's position (as was also the case with the first decision of the Municipal Court). At the end of the hearing, the High Court announced the Second Appellate Decision by which it reversed the second decision of the Municipal Court and ordered Telefónica to pay 644 million Czech koruna (approximately 23 million euros) to Venten and 227 Czech koruna (approximately 8 million euros) to Lexburg, in each case plus interest.

On December 28, 2016, the decision was notified to Telefónica. Telefónica has filed an extraordinary appeal, requesting the suspension of the effects of the decision.

In March 2017, Telefónica was notified of the decision of the Supreme Court, which ordered the suspension of the effects of the unfavorable decision to Telefónica issued by the High Court.

Venten and Lexburg filed with the Supreme Court a motion to partially abolish the suspension of enforceability of the Decision of the High Court in Prague. On January 17, 2018, Telefónica filed its response seeking dismissal of such motion for lack of legal basis.

c) Other contingencies

Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about these matters and intends to cooperate with those authorities as the investigations continue. It is not possible at this time to predict the scope or duration of these matters or their likely outcome.

d) Commitments

Agreement related to the Sale of Customer Relationship Management (CRM) Business, Atento

As a result of the sale agreement of Atento by Telefónica, announced on October 12, 2012, and ratified on December 12, 2012, both companies signed a Master Service Agreement which regulates Atento's relationship with the Telefónica Group as a service provider for a period of nine years and which was amended on May 16, 2014, and on November 8, 2016. This period was extended only for Spain and Brazil in November 2016, for two additional years until 2023.

By virtue of this Agreement, Atento became Telefónica's preferred Contact Center and Customer Relationship Management (CRM) service provider, stipulating annual commitments in terms of turnover which is updated based on inflation and deflation that vary from country to country, pursuant to the volume of services Atento has been providing to the entire Group. Effective January 1, 2017, the minimum volume commitments that Telefónica must comply with have significantly decreased from Brazil.

Failure to meet the annual turnover commitments generally results in the obligation to the counterparty, to pay additional amounts, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contact Center's business margin to the final calculation.

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

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

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

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

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

Directors' and Senior Executives' compensation

The compensation of the members of Telefónica's Board of Directors is governed by article 35 of the Company's By-Laws, which provides that the annual amount of the compensation to be paid thereby to all of the Directors in their capacity as such, i.e., as members of the Board of Directors and for the performance of the duty of supervision and collective decision-making inherent in such body, shall be fixed by the shareholders at the General Shareholders' Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors, taking into account the duties and responsibilities assigned to each Director, their membership on Committees within the Board of Directors and other objective circumstances that it deems relevant. Furthermore, Executive Directors shall receive such compensation as the Board determines for the performance of executive duties delegated or entrusted to them by the Board of Directors. Such compensation shall conform to the Director compensation policy approved by the shareholders at the General Shareholders' Meeting.

In accordance with the foregoing, the shareholders acting at the Ordinary General Shareholders' Meeting held on April 11, 2003 set at 6 million euros the maximum amount of annual gross compensation to be received by the Board of Directors as a fixed allotment and as attendance fees for attending the meetings of the Advisory or Control Committees of the Board of Directors. Thus, as regards fiscal year 2017, the total amount of compensation received by the Directors of Telefónica, in their capacity as such, was 3,277,934 euros for the fixed allocation and for attendance fees.

The compensation of the Directors of Telefónica in their capacity as members of the Board of Directors, of the Executive Commission and/or of the Advisory or Control Committees consists of a fixed amount payable monthly and of attendance fees for attending the meetings of the Advisory or Control Committees.

Set forth below are the amounts established in fiscal year 2017 as fixed amounts for belonging to the Board of Directors, the Executive Commission and the Advisory or Control Committees of Telefónica and the attendance fees for attending meetings of the Advisory or Control Committees of the Board of Directors.

Compensation of the Board of Directors and of the Committees thereof

Amounts in euros Position	Board of Directors	Executive Commission	Advisory or Control Committees (*)
Chairman	240,000	80,000	22,400
Vice chairman	200,000	80,000	–
Executive Member	–	–	–
Proprietary Member	120,000	80,000	11,200
Independent Member	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(*) In addition, the amount of the attendance fee for each of the meetings of the Advisory or Control Committees is 1,000 euros.

In this regard, it is noted that the current Executive Chairman, Mr. José María Álvarez-Pallete López, has waived the receipt of the above amounts (i.e., 240,000 euros as Chairman of the Board of Directors and 80,000 euros as Chairman of the Executive Commission).

Likewise, the fixed remuneration of 1,923,100 euros that the Executive Chairman, Mr. José María Álvarez-Pallete López, has established for the 2018 financial year is equal to the one received in the years 2017 and 2016, which was set in his capacity as Chief Executive Officer, remaining invariably after his appointment as Chairman. This compensation is a 13.8% lower to the compensation established for the position of Executive Chairman prior to his appointment as such.

Individualized description

Annex II provides an individual breakdown by item of the compensation and benefits that the members of the Board of Directors and of the Senior Management of the Company have received from Telefónica, S.A. and from other companies of the Telefónica Group during fiscal year 2017.

f) Related-party transactions

Significant shareholders

The significant shareholders of the Company are Bilbao Vizcaya Argentaria, S.A. (BBVA), Blackrock, Inc. and Caja de Ahorros y Pensiones de Barcelona ("la Caixa") with stakes in Telefónica, S.A. of 5.17%, 6.63% and 5.01%, respectively.

During 2017 and 2016 the Group did not carry out any significant transactions with Blackrock, Inc., other than the dividends paid corresponding to its stake.

A summary of significant transactions between Telefónica, S.A. and the companies of BBVA and those of la Caixa, carried out at market prices, is as follows:

Millions of euros

2017	BBVA	la Caixa
Financial expenses	9	4
Receipt of services	2	2
Total expenses	**11**	**6**
Financial revenues	—	—
Dividends received (1)	11	—
Total revenues	**11**	**—**
Financing transactions	1,209	414
Guarantees granted	—	8
Time deposits	995	292
Dividends distributed	128	104

(1) As of December 31, 2017 Telefónica holds 0.66% investment in BBVA (See Note 9.3.).

Millions of euros

2016	BBVA	la Caixa
Financial expenses	9	1
Receipt of services	2	2
Total expenses	**11**	**3**
Financial revenues	—	—
Dividends received (1)	15	—
Total revenues	**15**	**—**
Financing transactions	244	203
Guarantees granted	—	8
Time deposits	350	45
Dividends distributed	243	185

(1) As of December 31, 2016 Telefónica holds 0.67% investment in BBVA (See Note 9.3.).

In addition, the nominal outstanding value of derivatives held with BBVA and la Caixa in 2017 amounted to 20,738 and 404 million euros, respectively (16,680 million euros held with BBVA and 392 million euros held with la Caixa in 2016). The fair value of these same derivatives in the balance sheet is 332 and -28 million euros, respectively, in 2017 (855 and -35 million euros, respectively, in 2016). As explained in Derivatives policy in Note 16, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying. Moreover, in 2017 there are collateral guarantees of certain derivatives held with BBVA amounting to 286 million euros (240 million euros in 2016).

Group companies and Associates

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

The balances and transactions between the Company and these subsidiaries (Group and Associated Companies) at December 31, 2017 and 2016 are detailed in the notes to these individual financial statements.

Directors and senior executives

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

Compensation and other benefits paid to members of the Board of Directors and senior executives are detailed in Note 20 d) and Appendix II of these financial statements.

Certain Telefónica Group subsidiaries performed in 2017 transactions with Global Dominion Access Group, related to the Group´s ordinary course of business (mainly in Telefónica de España amounting to 23 million euros). Furthermore, certain Telefónica Group subsidiaries performed in 2016 transactions with the Inditex Group, related to the Group's ordinary course of business, concerning telecommunications and related services, amounting to 36 million euros. In 2017 the aforementioned company is not related parties anymore.

Telefónica S.A. contracted a civil liability insurance scheme (D&O) for Directors, managers and staff with similar functions in the Telefónica Group, with standard conditions in these type of insurance and a premium attributable to 2017 of 1,943,007.09 euros (2,088,500 euros in 2016). This scheme provides coverage for Telefónica S.A. and its subsidiaries, in certain cases.

g) Auditors' fees

The expenses accrued in 2017 in respect of the fees for services rendered to the various member firms of the PwC international organization, of which PricewaterhouseCoopers Auditores, S.L. (the auditor of Telefónica) forms part, amounted to 3.56 million euros. The expenses accrued in 2016 in respect of the fees for services rendered to the various member firms of the EY international organization, of which Ernst & Young, S.L. (the auditors of Telefónica) forms part, amounted to 4.73 million euros.

The detail of these amounts is as follows:

Millions of euros	2017	2016
Audit services	3.16	4.52
Audit-related services	0.16	0.21
Other services	0.24	—
Total	**3.56**	**4.73**

Audit services: mainly audit services of the annual and reviews of interim financial statements, services related to the issuance of comfort letters, work to comply with the requirements of the Sarbanes-Oxley Act (Section 404) and the work in connection with the 20-F report to be filed with the US Securities and Exchange Commission (SEC).

Audit-related services: services related to the review of the information required by regulatory authorities, agreed financial reporting procedures not requested by legal or regulatory bodies and the review of corporate responsibility reports.

All other services: permitted services by the applicable independence regulation, mainly advisory services on migration questions to expatriates employees.

h) Environmental matters

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

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

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

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

i) Trade and other guarantees

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

Note 21. Cash flow analysis

Cash flows from/(used in) operating activities

The net result before tax in 2017 amounted to positive 274 million euros (see income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year.

These adjustments relate mainly to:

- The impairment of investments in Group companies, associates and other investments of 1,443 million euros (in 2016 there was an impairment reversal of 2,049 million euros).

- The gains on disposal of subsidiaries amounting to 313 million euros, corresponding mainly to the sale of Telxius Telecom, S.A.U. (996 million euros in 2016).

- Declared dividends as income in 2017 for 3,027 million euros (1,928 million euros in 2016), interest accrued on loans granted to subsidiaries of 95 million euros (175 million euros in 2016) and a net financial expense of 1,773 million euros (2,227 million euros in 2016), adjusted initially to include only movements related to cash inflows or outflows during the year under “Other cash flows from operating activities.”

“Other cash flows from operating activities” amounted to 1,364 million euros (3,314 million euros in 2016). The main items included are:

a) Net interest paid:

Payments of net interest and other financial expenses amounted to 1,505 million euros (1,868 million euros in 2016), including:

- Net proceeds from external credit entities, net of hedges, for 396 million euros, (net payments of 84 million euros in 2016 discounted by their hedges), and

- Interest and hedges paid to Group companies of 1,901 million euros (1,952 million euros in 2016).

b) Dividends received:

The main receipts relate to:

Millions of euros	2017	2016
Telefónica Móviles Argentina, S.A.	163	—
Telefónica Móviles España, S.A.U.	—	373
Telefónica Europe, plc.	619	616
Telfin Ireland, Ltd.	—	455
Telefónica Latinoamérica Holding, S.L.	1,650	1,828
Telefónica International Wholesale Services, S.L.	—	500
Telefônica Brasil, S.A.	294	236
Sao Paulo Telecomunicaçoes, Ltda	116	65
Other dividend collections	79	139
Total	**2,921**	**4,212**

In addition to the dividends recognized as income in 2017 (see Note 19.1) and collected in the same period, this caption also includes dividends from 2016 collected in 2017.

c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. Payments of totaling 131 million euros were made in 2017 (150 million in 2016), as disclosed in Note 17 and income taxes repayments of 2015 and 2016 have been received amounting to 5 million euros. In this regard, the main amounts passed on to subsidiaries of the tax group were as follows:

- Telefónica Móviles España, S.A.U.: collection of 110 million euros, corresponding to: 86 million euros for the 2016 income tax settlement and 24 million in payments of account of 2017 income tax.

  In 2016, there was an income collected of 165 millions euros, mainly due to the settlement of income tax of 146 million euros in 2015, 98 million euros of tax payments in 2016 and for a payment of 79 million corresponding to the settlement agreed with the Tax Authorities for 2008-2011 income tax inspection.

- Telefónica de España, S.A.U.: collection of 215 million euros, corresponding to: 134 million euros for the 2016 income tax settlement and 81 million in payments of account of 2017 income tax.

  In 2016 the amount collected was 640 million euros, corresponding to: 367 million euros for the 2015 income tax settlement, 263 million euros related to payment in account of 2016 income tax and 10 million corresponding to the settlement agreed with the Tax Authorities for 2008-2011 income tax inspection.

Cash flows from/(used in) investing activities

“Payments on investments” under “Cash flows from/ (used in) investing activities" included a total payment of 6,441 million euros (5,002 million euros in 2016). The main transactions to which these payments refer are as follows:

- Capital increases: the main disbursements correspond to Telefónica Latinoamérica Holding, S.L. amounting to 3,838 million euros, Telefónica Móviles México, S.A. de C.V. amounting to 129 million euros and Telefónica Digital Holding, S.L.U. amounting to 220 million euros. These capital increases, as well as other minor disbursements of this same concept are disclosed fully in Note 8.1.a).

- Payments of financial investments related to the reinvestment of treasury overage amounting 1,400 million euros.

- Payments of collaterals related to financial derivatives amounting to 781 million euros.

Proceeds from disposals totaling 3,612 million euros in 2017 (3,439 million euros in 2016) includes:

- Proceeds from the sale of 40% investment in Telxius Telecom, S.A.U. amounting to 1,275 million euros (see Note 8).

- Proceeds from the sale of the investment in Telefónica Deuschland Holding AG which was acquired in March 2017 as a result of the share swap transaction with KPN amounting to 749 million euros.

- Repayment of a loan granted to Telefónica Contenidos, S.A.U. for a total of 340 million euros as well as repayment of a credit line granted to Telefónica de España, S.A.U. totaling 165 million euros (see Note 8).

- Proceeds from financial investments related to the reinvestment of treasury overage amounting 703 million euros.

Cash flows from/(used in) financing activities

This caption includes the following items:

i. Net payments for equity instruments of 10 million euros (net payments by 624 million euros in 2016), relating to the treasury shares granted in 2017 as a consequence of the vesting of several employees' share plans. In 2017 there are no disbursements corresponding to treasury share acquisition (see Note 11).

ii. Proceeds from financial liabilities:

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

Millions of euros	2017	2016
Telefónica Participaciones, S.A.U. (Note 15)	—	608
Syndicated facilities with several entities (Note 14.4)	—	4,650
Bilateral loans with several entities (Note 14.4)	—	265
Telefónica Emisiones, S.A.U. (Note 15)	7,324	4,900
Telefónica Europe, B.V. promissory notes (Note 15)	—	1,200
Telfisa Global, B.V. financing (Note 15)	3,759	998
Structured Financing	558	699
Promissory notes (Note 13)	—	305
Credit lines with several entities	1,016	—
Bonds issued by Telefónica Europe B.V. (Note 15)	1,750	1,000
Loan (Note 14)	—	300
Other collections	280	959
Total	**14,687**	**15,884**

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

Millions of euros	2017	2016
Bond redemption (Note 13)	727	—
Bilateral loans with several entities (Note 14.4)	665	—
Syndicated facilities with several entities (Note 14.4)	550	5,300
Telefónica Europe, B.V. (Note 15)	—	80
Telefónica Europe, B.V. promissory notes (Note 15)	779	—
Telefónica Finanzas, S.A.U.	—	497
Telefónica Emisiones, S.A.U. (Note 15)	5,232	6,540
Structured Financing	542	302
Credit lines with several entities	460	358
Promissory notes (Note 13)	166	—
Other payments	236	712
Total	**9,357**	**13,789**

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

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

iii. Payments of dividends for 1,904 million euros (2,395 million euros in 2016) as described in Note 11.1. d). The difference between the figure of Dividends shown in this Note and in Note 11 is caused by withholding taxes deducted in the payment to certain major shareholders, which will be paid to Tax Authorities in 2018.

Note 22. Events after the reporting period

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

Financing

- On January 22, 2018, Telefónica, S.A. drew down 100 million euros of its bilateral loan signed on December 28, 2017 and maturing in 2020.
- On January 22, 2018, Telefónica Emisiones, S.A.U. launched under its EMTN Programme, updated on June 29, 2017, an issuance of notes amounting to 1,000 million euros. These notes are due on January 22, 2027, pay an annual coupon of 1.447% and are guaranteed by Telefónica, S.A.
- On January 23, 2018, Telefónica, S.A. drew down 385 million euros of its bilateral loan signed on December 20, 2017 and maturing in 2019.
- On January 30, 2018, Telefónica, S.A. drew down 100 million euros of its bilateral loan signed on November 24, 2017 and maturing in 2026.
- On February 2, 2018, Telefónica Emisiones, S.A.U. redeemed 750 million sterling pounds of its notes issued on February 2, 2006. The notes were guaranteed by Telefónica, S.A.

Investments

- In order to provide the funds needed to rebalance its equity and to execute share capital increases in its direct affiliates, Telefónica Digital España, S.L.U. on January 11, 2018 carried out a capital increase amounting to 194 million euros, totally subscribed and disboursed by Telefónica, S.A.

New organizational structure

The Board of Directors of Telefónica, S.A., at its meeting held on January 31, 2018, resolved to adopt a new organizational structure in order to make the Company more agile, simple and focused on management, customer service, growth, efficiency and profitability.

The main changes are detailed below:

- the areas of General Counsel, and Public Affairs and Regulation, up until now led by Mr. Ramiro Sánchez de Lerín and Mr. Carlos López Blanco respectively, is unified and headed by Mr. Pablo de Carvajal.
- Mr. Emilio Gayo will replace Mr. Luis Miguel Gilpérez as Executive Chairman of Telefónica España and member of the Executive Committee of Telefónica, S.A.
- Telefónica Hispanoamérica, until now headed by Mr. Eduardo Caride (also a member of the Executive Committee), is split into two new units in order to more effectively manage the different market situations: Telefónica Hispam Sur unit is created (encompassing operations in Argentina, Chile, Peru and Uruguay), which is led by Mr. Bernardo Quinn (until now Director of Global Human Resources), and Telefónica Hispam Norte unit is created (encompassing the operations in Colombia, México, Central America, Ecuador and Venezuela), which is led by Mr. Alfonso Gómez Palacio.
- the area of People (Human Resources) is enhanced and will report directly to the Executive Chairman. This area will be led by Ms. Marta Machicot, who will join the Executive Committee.

Note 23. Additional note for English translation

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company's Directors in the meeting held on February 21, 2018. In the event of a discrepancy, the Spanish-language version prevails.

Appendix I: Details of subsidiaries and associates at December 31, 2017

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica Latinoamérica Holding, S.L. (SPAIN) Holding company Distrito Telefónica. Ronda de la comunicación s/n 28050 Madrid	100.00%	—	237	12,922	—	(301)	225	17,166
Telefónica Móviles España, S.A.U. (SPAIN) Wireless communications services provider Distrito Telefónica, Ronda de la Comunicación s/n 28050 Madrid	100.00%	—	209	537	305	740	626	5,561
Telfin Ireland Limited (IRELAND) Intragroup financing 28/29 Sir John Rogerson's Quay, Dublin 2	100.00%	—	—	8,370	—	—	140	8,187
Telefónica Europe, plc (UNITED KINGDOM) Wireless communications Wellington Street, Slough, SL11YP	100.00%	—	13	15,204	619	(1,070)	(450)	10,707
Telefónica Móviles México, S.A. de C.V. (MEXICO) Holding company Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, México D.F. CP.05349	100.00%	—	4,992	(3,697)	—	18	(132)	1,021
Telefónica de España, S.A.U. (SPAIN) Telecommunications service provider in Spain Gran Vía, 28 - 28013 Madrid	100.00%	—	1,024	1,683	664	2,100	1,580	2,455
O2 (Europe) Ltd. (UNITED KINGDOM) Holding company Wellington Street, Slough, SL11YP	100.00%	—	1,239	5,258	—	(1,621)	(1,623)	2,764
Telefónica de Contenidos, S.A.U. (SPAIN) Organization and operation of multimedia service-related activities and businesses Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	—	226	1,111	—	(102)	(177)	1,160
Telfisa Global, B.V. (NETHERLANDS) Integrated cash management, consulting and financial support for Group companies Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX - Amsterdam	100.00%	—	—	712	733	(7)	852	712
Telefónica Chile Holdings, S.L (SPAIN) Holding company Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	—	—	1,209	—	—	—	473
Telefónica Innovación Alpha, S.L. (SPAIN) Telecommunications activities Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100.00%	—	—	8	—	(10)	(7)	11
Telco TE, S.p.A. (ITALY) Holding company Via dell'Annunciata n.21 - 20121 Milano	100.00%	—	—	—	—	—	—	—
Panamá Cellular Holdings, B.V. (NETHERLANDS) Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%	—	—	1	—	—	—	1
Teléfonica de Costa Rica TC, S.A. (COSTA RICA) Holding company Plaza Roble, Edificio Los Balcones 4º, San José	100.00%	—	296	(170)	—	12	12	296
Telefónica Global Technology, S.A.U. (SPAIN) Global management and operation of IT systems Gran Vía, 28 - 28013 Madrid	100.00%	—	46	141	—	(29)	(12)	152

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica Capital, S.A. (SPAIN) Finance company Gran Via, 28 - 28013 Madrid	100.00%	—	7	151	—	—	25	110
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) Life insurance, pensions and health insurance Ronda de la Comunicación, s/n Distrito Telefónica Edificio Oeste 1, planta 9 - 28050 Madrid	100.00%	—	51	63	5	7	10	69
Telefónica Digital España, S.L.U. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica Edificio Central - 28050 Madrid	100.00%	—	15	371	—	(187)	(150)	237
Taetel, S.L. (SPAIN) Holding company Gran Via, 28 - 28013 Madrid	100.00%	—	28	39	—	—	—	67
Telefónica Internacional USA, Inc. (U.S.A.) Financial Advisory services 1221 Brickell Avenue suite 600 - 33131 Miami - Florida	100.00%	—	—	1	—	—	—	—
Lotca Servicios Integrales, S.L. (SPAIN) Holding, operation and aircraft leases Gran Vía, 28 - 28013 Madrid	100.00%	—	17	72	—	(18)	(14)	75
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) Security services and systems Ramón Gómez de la Serna, 109-113 Posterior 28035 Madrid	100.00%	—	12	(7)	—	(1)	(3)	5
Compañía Española de Tecnología, S.A. (SPAIN) Promotion of business initiatives and holding of real estate assets Gran Vía, 28 - 28013 Madrid	100.00%	—	5	5	—	—	—	9
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN) Integrated cash management, consulting and financial support for Group companies Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	—	3	51	—	(1)	57	13
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) Design of communications products Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid	100.00%	—	N/D	N/D	N/D	N/D	N/D	—
Telefónica International Wholesale Services II, S.L. (SPAIN) International services provider Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	—	231	5	—	(36)	(41)	99
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN) Telecommunications research activities and projects Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	—	7	(2)	—	10	8	12
Telefónica Luxembourg Holding S.à.r.L. (LUXEMBOURG) Holding company 26, rue Louvingny, L-1946- Luxembourg	100.00%	—	3	87	—	—	174	4
Telefónica Servicios Globales, S.L.U. (SPAIN) Management and administrative services rendered Ronda de la Comunicación, s/n – 28050 Madrid	100.00%	—	1	18	—	(2)	(1)	14

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Fisatel Mexico, S.A. de C.V. (MEXICO) Integrated cash management, consulting and financial support for Group Companies Boulevard Manuel Avila Camacho, 24 - 16ª Plta. - Lomas de Chapultepec - 11000 México D.F.	100.00%	—	195	(29)	—	—	14	181
Telefónica Participaciones, S.A.U. (SPAIN) Issues of preferred shares and/or other debt financial instruments Gran Via, 28 - 28013 Madrid	100.00%	—	—	1	—	—	—	—
Telefónica Emisiones, S.A.U. (SPAIN) Issues of preferred shares and/or other debt financial instruments Gran Via, 28 - 28013 Madrid	100.00%	—	—	10	—	(2)	2	—
Telefónica Europe, B.V. (NETHERLANDS) Fund raising in capital markets Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX – Amsterdam	100.00%	—	—	5	2	(1)	2	—
O2 Oak Limited (UNITED KINGDOM) Private Limited Company 260 Bath Road, Slough Berkshire SL1 4BX	100.00%	—	—	—	—	—	—	—
O2 Worldwide Limited (UNITED KINGDOM) Private Limited Company 20 Air Street, London, England WIB 5AAN	100.00%	—	—	—	—	—	—	—
Telefónica Consumer Finance E.F.C., S.A. (SPAIN) Lending and consumer loans c/Caleruega, 102 -28033 Madrid	50.00%	—	5	31	—	12	7	15
Telxius Telecom, S.A.U. (SPAIN) Investment, administration and managament of companies in the telecommunications sector Ronda de la Comunicación, s/n. - 28050 Madrid	60.00%	—	250	2,185	—	(8)	20	1,440
Corporation Real Time Team, S.L. (SPAIN) Internet design, advertising and consulting Plaza Canalejas, 3 – 28014 Madrid	87.96%	12.04%	—	—	—	—	—	—
Telefónica Móviles Argentina, S.A. (1) (ARGENTINA) Mobile communications and services operator Ing Enrique Butty 240, piso 20 - Buenos Aires	73.20%	26.80%	197	813	164	629	351	1,359
Telefónica Centroamérica Inversiones, S.L (SPAIN) Holding company Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	60.00%	—	1	876	34	(168)	(114)	655
Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) Holding company Torre Edicampo, Avda. Francisco de Miranda, Caracas 1010	65.14%	34.86%	—	—	—	—	—	—
Aliança Atlântica Holding B.V. (NETHERLANDS) Portfolio company Strawinskylaan 1725 – 1077 XX – Amsterdan	50.00%	50.00%	150	(107)	—	—	—	21
Sao Paulo Telecomunicaçoes Participaçoes, Ltda (BRAZIL) Holding company Rua Martiniano de Caravalho, 851 20º andar, parte, Sao Paolo	39.40%	60.60%	5,346	(1,199)	130	(24)	320	2,198
Telefônica Brasil, S.A. (BRAZIL) (1)(*) Wireline telephony operator in Sao Paulo Sao Paulo	29.77%	43.76%	23,164	(5,576)	355	1,874	1,310	9,418

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Colombia Telecomunicaciones, S.A. ESP (COLOMBIA) Wireless operator Calle 100, Nº 7-33, Piso 15, Bogotá,Colombia	7.90%	59.60%	—	1,502	—	132	99	272
Pléyade Peninsular, Correduría de Seguros y Reaseguros del grupo Telefónica, S.A. (SPAIN) Insurance contracts,operating as a broker Distrito Telefónica, Ronda de la Comunicación, s/n Edificio Oeste 1 – 28050 Madrid	16.67%	83.33%	—	(1)	1	4	5	—
Telefónica Móviles Chile, S.A. (CHILE) Mobile communications operator Miraflores, 130 - 12º - Santiago de Chile	1.13%	98.87%	—	—	4	—	—	57
Telefónica de Argentina, S.A. (1) (ARGENTINA) Telecommunications services provider Av. Ingeniero Huergo, 723, PB – Buenos Aires	1.61%	98.39%	232	241	—	52	(10)	16
Telefónica Venezolana, C.A. (VENEZUELA) (1) Mobile communications operator Av. Francisco de Miranda, Edif. Parque Cristal, Caracas 1060	0.09%	99.91%	—	—	—	—	—	—
Telefónica Canal 21, S.C. (SPAIN) TV Channel Ronda de la comunicación s/n Edif.Norte 1. Planta 5 28050 Madrid	50.00%	—	18	(10)	—	(4)	(4)	2
Telefónica Factoring España, S.A. (SPAIN) Factoring Zurbano, 76, 8 Plta. - 28010 Madrid	50.00%	—	5	2	4	5	7	—
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) Factoring México D.F.	40.50%	9.50%	2	—	1	(1)	1	1
Telefónica Factoring Perú, S.A.C. (PERÚ) Factoring Lima	40.50%	9.50%	1	2	1	—	2	1
Telefónica Factoring Colombia, S.A. (COLOMBIA) Factoring Bogotá	40.50%	9.50%	1	—	—	1	1	1
Telefónica Factoring Chile, S.A. (CHILE) Factoring Santiago de Chile	40.50%	9.50%	—	—	—	1	—	—
Telefónica Factoring Do Brasil, Ltd. (BRAZIL) Factoring Avda. Paulista, 1 106 – Sao Paulo	40.00%	10.00%	1	(2)	5	(2)	14	1
Jubii Europe N.V. (NETHERLANDS) (*) Internet portal Richard Holkade 36, 2033 PZ Haarlem	32.10%	—	N/D	N/D	—	N/D	N/D	4
Torre de Collçerola, S.A. (SPAIN) Operation of telecommunicatios mast and technical assistance and consulting services. Ctra. Vallvidrera-Tibidabo, s/n - 08017 Barcelona	30.40%	—	6	—	—	—	—	2
Total group companies and associates					**3,027**			**67,025**

(1) Consolidated data.
(*) Companies listed on international stock exchanges at December 31, 2017.

Appendix II: Board and Senior Management Compensation

TELEFÓNICA, S.A.

(Amounts in euros)

Directors	Salary[1]	Fixed compen-sation[2]	Attendance fees[3]	Short-term variable compensation[4]	Compensation for belonging to Committees of the Board[5]	Other items[6]	Total
Mr. José María Álvarez-Pallete López	1,923,100	—	—	3,430,430	—	5,802	5,359,332
Mr. Isidro Fainé Casas	—	200,000	—	—	80,000	—	280,000
Mr. José María Abril Pérez	—	200,000	7,000	—	91,200	—	298,200
Mr. Ángel Vilá Boix[7]	697,490	—	—	—	—	7,341	704,831
Ms. Eva Castillo Sanz	—	120,000	27,000	—	33,600	—	180,600
Mr. Juan Ignacio Cirac Sasturain	—	120,000	9,000	—	11,200	—	140,200
Mr. José Javier Echenique Landiríbar	—	120,000	18,000	—	109,867	—	247,867
Mr. Peter Erskine	—	120,000	17,000	—	113,600	—	250,600
Ms. Sabina Fluxà Thienemann	—	120,000	10,000	—	11,200	—	141,200
Mr. Luiz Fernando Furlán	—	120,000	5,000	—	7,467	—	132,467
Ms. Carmen García de Andrés[7]	—	78,667	8,000	—	12,009	—	98,676
Mr. Peter Löscher	—	120,000	9,000	—	11,200	—	140,200
Mr. Ignacio Moreno Martínez	—	120,000	28,000	—	38,267	—	186,267
Mr. Francisco Javier de Paz Mancho	—	120,000	34,000	—	124,800	—	278,800
Mr. Francisco José Riberas Mera[7]	—	78,667	—	—	—	—	78,667
Mr. Wang Xiaochu	—	120,000	—	—	—	—	120,000

1 Salary: Regarding Mr. José María Álvarez-Pallete López, it includes the amount of non-variable payments and that which the Board Member has received for his executive tasks. Regarding Mr. Ángel Vilá Boix, he was appointed Board Member of the Company on July 26, 2017, including from this date the amount of non-variable payments and that which the Board Member has received for his executive tasks.
2 Fixed remuneration: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and received by the Board Member for their membership to the Board, regardless of the effective attendance of the Board Member to the Board meetings.
3 Allowance: Total amount of the allowances for attending the meetings of the Advisory or Control Committees.
4 Short-term variable remuneration (bonus): Variable amount linked to the performance or the achievement of a series of individual or group objectives (quantitative or qualitative) in a period equal to or less than one year, corresponding to 2016 and paid in 2017. With regard to the bonus corresponding to 2017, and which will be paid in 2018, Executive Board Member Mr. José María Álvarez-Pallete López will earn 3,426,964 euros and Executive Board Member Mr. Ángel Vilá Boix will earn 990,000 euros (the Bonus of Mr. Vilá only includes the amount accrued since his appointment as Director of the Company, on July 26, 2017).
5 Remuneration for membership to the Board Committees: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and received by the Board Member for their membership to the Delegated Committee and to the Advisory or Control Committees, regardless of the effective attendance of the Board Member to the Advisory or Control Committee meetings.
6 Other items: Among others, it includes the amounts received in concept of payment in kind (general medical insurance and dental and vehicle coverage), fulfilled by Telefónica, S.A.
7 Ms. Carmen García de Andrés and Mr. Francisco José Riberas Mera were appointed Board Members of the Company on May 4, 2017, and Mr. Ángel Vilá Boix was appointed Board Member on July 26, 2017, reflecting, therefore, the received payment, respectively, from the dates mentioned.

Likewise, Mr. César Alierta Izuel, Mr. Gonzalo Hinojosa Fernández de Angulo, and Mr. Pablo Isla Álvarez de Tejera, stood down as Board Members on May 4, 2017, Mr. Julio Linares López stood down as Board Member on July 26, 2017, and Mr. Antonio Massanell Lavilla stood down as Board Member on December 21, 2017, reflecting below the payment received by them, respectively, in 2017 until the dates mentioned.

Directors	Salary[1]	Fixed compen-sation[2]	Attendance fees[3]	Short-term variable compensation[4]	Compensation for belonging to Committees of the Board[5]	Other items[6]	Total
Mr. César Alierta Izuel	—	213,556	—	—	—	169	213,725
Mr. Gonzalo Hinojosa Fernández de Angulo	—	41,333	4,000	—	46,845	—	92,178
Mr. Pablo Isla Álvarez de Tejera	—	41,333	—	—	3,858	—	45,191
Mr. Julio Linares López	—	116,667	11,000	—	19,600	—	147,267
Mr. Antonio Massanell Lavilla	—	120,000	30,000	—	56,000	—	206,000

1 Salary: Includes the amount of non-variable payments and that which the Board Member has received for their executive tasks.
2 Fixed remuneration: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and received by the Board Member for their membership to the Board, regardless of the effective attendance of the Board Member to the Board meetings.
3 Allowance: Total amount of the allowances for attending the meetings of the Advisory or Control Committees.
4 Short-term variable remuneration (bonus): Variable amount linked to the performance or achievement of a series of individual or group objectives (quantitative or qualitative) in a period equal to or less than one year, corresponding to 2016 and paid in 2017.
5 Remuneration for membership to the Board Committees: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and received by the Board Member for their membership to the Delegated Committee and to the Advisory or Control Committees, regardless of the effective attendance of the Board Member to the Advisory or Control Committee meetings.
6 Other items: Among others, it includes the amounts received under payment in kind (general medical insurance and dental coverage), fulfilled by Telefónica, S.A.

Likewise, specifying the figures included in the previous box, the payment received by the Board Members of Telefónica for their membership to the different Advisory or Control Committees during 2017 is specifically detailed below, including both fixed allocation and attendance allowances.

ADVISORY OR CONTROL COMMITTEES OF TELEFÓNICA, S.A.

(Amounts in euros)

Directors	Audit and Control	Nominating, Compensation and Corporate Governance	Service Quality and Customer Service	Strategy and Innovation	Regulation and Institutional Affairs	TOTAL 2017
Mr. José María Álvarez-Pallete López	—	—	—	—	—	—
Mr. Isidro Fainé Casas	—	—	—	—	—	—
Mr. José María Abril Pérez	—	—	—	18,200	—	18,200
Mr. Ángel Vilá Boix	—	—	—	—	—	—
Ms. Eva Castillo Sanz	—	—	17,200	22,200	21,200	60,600
Mr. Juan Ignacio Cirac Sasturain	—	—	—	20,200	—	20,200
Mr. José Javier Echenique Landiríbar	34,400	13,467	—	—	—	47,867
Mr. Peter Erskine	—	19,200	—	31,400	—	50,600
Ms. Sabina Fluxà Thienemann	—	21,200	—	—	—	21,200
Mr. Luiz Fernando Furlán	—	12,467	—	—	—	12,467
Ms. Carmen García de Andrés	13,342	—	6,667	—	—	20,009
Mr. Peter Löscher	—	—	—	20,200	—	20,200
Mr. Ignacio Moreno Martínez	22,200	—	17,200	—	26,867	66,267
Mr. Francisco Javier de Paz Mancho	23,200	33,400	—	—	22,200	78,800
Mr. Francisco José Riberas Mera	—	—	—	—	—	—
Mr. Wang Xiaochu	—	—	—	—	—	—

Mr. César Alierta Izuel, Mr. Gonzalo Hinojosa Fernández de Angulo, and Mr. Pablo Isla Álvarez de Tejera, stood down as Board Members on May 4, 2017, Mr. Julio Linares López stood down as Board Member on July 26, 2017, and Mr. Antonio Massanell Lavilla stood down as Board Member on December 21, 2017, reflecting below the payment received by them, respectively, in 2017 until the dates mentioned.

Directors	Audit and Control	Nominating, Compensation and Corporate Governance	Service Quality and Customer Service	Strategy and Innovation	Regulation and Institutional Affairs	TOTAL 2017
Mr. César Alierta Izuel	—	—	—	—	—	—
Mr. Gonzalo Hinojosa Fernández de Angulo	4,858	5,858	3,858	3,858	4,858	23,290
Mr. Pablo Isla Álvarez de Tejera	—	3,858	—	—	—	3,858
Mr. Julio Linares López	—	—	9,533	—	21,067	30,600
Mr. Antonio Massanell Lavilla	23,200	—	28,400	15,200	19,200	86,000

The following table breaks down the amounts received from other companies of the Telefónica Group other than Telefónica, S.A. individually, by the Board Members of the Company, by the performance of executive duties or by their membership to the Board of Directors of said companies:

OTHER COMPANIES OF THE TELEFÓNICA GROUP

(Amounts in euros)

Directors	Salary[1]	Fixed compen-sation[2]	Attendance fees[3]	Short-term variable compensation[4]	Compensation for belonging to Committees of the Board[5]	Other items[6]	Total
Mr. José María Álvarez-Pallete López	—	—	—	—	—	—	—
Mr. Isidro Fainé Casas	—	—	—	—	—	—	—
Mr. José María Abril Pérez	—	—	—	—	—	—	—
Mr. Ángel Vilá Boix	—	—	—	—	—	—	—
Ms. Eva Castillo Sanz	—	80,000	—	—	—	—	80,000
Mr. Juan Ignacio Cirac Sasturain	—	—	—	—	—	—	—
Mr. José Javier Echenique Landiríbar	—	—	—	—	—	—	—
Mr. Peter Erskine	—	12,403	—	—	—	—	12,403
Ms. Sabina Fluxà Thienemann	—	—	—	—	—	—	—
Mr. Luiz Fernando Furlán	—	98,418	—	—	—	—	98,418
Ms. Carmen García de Andrés	—	—	—	—	—	—	—
Mr. Peter Löscher	—	—	—	—	—	—	—
Mr. Ignacio Moreno Martínez	—	—	—	—	—	—	—
Mr. Francisco Javier de Paz Mancho	—	285,464	—	—	—	—	285,464
Mr. Francisco José Riberas Mera	—	—	—	—	—	—	—
Mr. Wang Xiaochu	—	—	—	—	—	—	—

1 Salary: Amount of non-variable payments and that which the Board Member of other companies of the Telefónica Group has received for their executive tasks.
2 Fixed remuneration: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and received by the Board Member for their membership to the board of directors of other Companies of the Telefónica Group.
It is hereby clarified that Mr. Eva Castillo Sanz has accrued an amount of 80,000 euros during 2017, for his membership to the Supervisory Board of Telefónica Deutschland Holding, A.G. Likewise, Mr. Peter Erskine has accrued an amount of 20,000 euros during 2017, for his membership to the Supervisory Board of Telefónica Deutschland Holding, A.G. Likewise, Mr. Ángel Vilá Boix has accrued an amount of 2,000 euros during 2017, for his membership to the Supervisory Board of Telefónica Deutschland Holding, A.G. On the drawing date of this document, none of the amounts mentioned have been paid, which is why they have not been consigned in the box (that only includes amounts received in 2017).
3 Allowance: Total amount of the allowances for attending the board of director meetings of other Companies of the Telefónica Group.
4 Short-term variable remuneration (bonus): Variable amount linked to the performance or achievement of a series of individual or group objectives (quantitative or qualitative) in a period equal to or less than one year, corresponding to 2016 and paid in 2017, by other companies of the Telefónica Group.
5 Remuneration for membership to the Board Committees of other companies of the Telefónica Group: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and accrued by the Board Member for their membership to the board of directors committees of other Companies of the Telefónica Group.
6 Other items: Among others, it includes the amounts received under payment in kind (general medical insurance and dental and vehicle coverage), fulfilled by other companies of the Telefónica Group.

Likewise, Mr. César Alierta Izuel, Mr. Gonzalo Hinojosa Fernández de Angulo, and Mr. Pablo Isla Álvarez de Tejera, stood down as Board Members on May 4, 2017, Mr. Julio Linares López stood down as Board Member on July 26, 2017, and Mr. Antonio Massanell Lavilla stood down as Board Member on December 21, 2017, reflecting below the payment received by them, respectively, in 2017 until the dates mentioned.

Directors	Salary[1]	Fixed compen-sation[2]	Attendance fees[3]	Short-term variable compensation[4]	Compensation for belonging to Committees of the Board[5]	Other items[6]	Total
Mr. César Alierta Izuel	—	—	—	—	—	—	—
Mr. Gonzalo Hinojosa Fernández de Angulo	—	9,125	—	—	—	—	9,125
Mr. Pablo Isla Álvarez de Tejera	—	—	—	—	—	—	—
Mr. Julio Linares López	—	—	—	—	—	—	—
Mr. Antonio Massanell Lavilla	—	—	—	—	—	—	—

1 Salary: Amount of non-variable payments and that which the Board Member of other companies of the Telefónica Group has received for their executive tasks.
2 Fixed remuneration: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and received by the Board Member for their membership to the board of directors of other Companies of the Telefónica Group.
3 Allowance: Total amount of the allowances for attending the board of director meetings of other Companies of the Telefónica Group.
4 Short-term variable remuneration (bonus): Variable amount linked to the performance or achievement of a series of individual or group objectives (quantitative or qualitative) in a period equal to or less than one year, corresponding to 2016 and paid in 2017, by other companies of the Telefónica Group.
5 Remuneration for membership to the Board Committees of other companies of the Telefónica Group: Amount of the compensation in cash, with a pre-established payment period, whether or not consolidated at the time and accrued by the Board Member for their membership to the board of directors committees of other Companies of the Telefónica Group.
6 Other items: Among others, it includes the amounts received under payment in kind (general medical insurance and dental and vehicle coverage), fulfilled by other companies of the Telefónica Group.

Additionally, as mentioned in the Retributive Policy section, the Executive Board Members have a series of Assistance Services. Below, the contributions made during 2017 are detailed for the Company's two long-term savings systems (Pension Plans and Social Welfare Plan):

LONG-TERM SAVINGS SYSTEMS

(Amounts in euros)

Directors	Contributions financial year 2017
Mr. José María Álvarez-Pallete López	673,085
Mr. Ángel Vilá Boix (since July 26, 2017)	268,922

The breakdown of the long-term saving systems includes contributions to Pension Plans, to the Benefit Plan and to the Unit link-type Insurance, as set out below:

(Amounts in euros)

Directors	Contributions to Pension Plans	Contributions to Benefits Plan[1]	Contributions to Unit link-type Insurance/ Pension Plan Surplus
Mr. José María Álvarez-Pallete López	6,060	540,968	126,057
Mr. Ángel Vila Boix (since July 26, 2017)	—	212,665	56,257

1 Contributions to the Executive Benefits Plan in 2006, funded solely by the Company, to supplement the Pension Plan in effect, which entails defined contributions equal to a particular percentage of the Officer's fixed compensation based on professional levels within the Telefónica Group's organization.

It is noted that in 2015 applicable law reduced the financial and tax limits of the contributions to Pension Plans; for this reason, in order to compensate for the difference in favor of the Beneficiaries, a Unit-link type group insurance policy was arranged to channel such differences that occur during each fiscal year.

This Unit-link type insurance is arranged with the entity Seguros de Vida y Pensiones Antares, S.A., and covers the same contingencies as those of the "Pension Plan" and the same exceptional liquidity events in case of serious illness or long-term unemployment.

The 2017 amounts for life insurance premiums were as follows:

LIFE INSURANCE PREMIUMS

(Amounts in euros)

Directors	Life insurance premiums
Mr. José María Álvarez-Pallete López	14,270
Mr. Ángel Vilá Boix (since July 26, 2017)	7,759
Mr. César Alierta Izuel (until May 4, 2017)	855

With regard to payment plans based on shares (in those in which the Executive Board Members participate exclusively), the following two long-term variable payment plans existed in effect for 2017:

1. The one named "Performance & Investment Plan" ("PIP") composed of three cycles (2014-2017; 2015-2018; 2016-2019), approved by the General Shareholder's Meeting held on May 30, 2014. The first cycle of this Plan started in 2014 and concluded in October of 2017. In accordance with that established in its general conditions, the delivery of shares did not occur in the first cycle of the Plan (2014-2017), therefore no share was delivered to the Executive Board Members that participated in this cycle.

The second cycle of this Plan started in 2015 and will end in October 2018.

With regard to the third cycle of this Plan (2016-2019), the Board of Directors of the Company, following a favorable report from the Appointments, Remuneration and Good Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

The number of theoretical shares assigned (without co-investment) is defined below, as well as the maximum number of shares assigned in the event of compliance with the "co-investment" requirement established in the Plan and of maximum compliance of the TSR objective fixed for the second cycle of the Plan.

PIP - Second phase / 2015-2018

Directors	Theoretical shares allocated (without co-investment)	Maximum number of shares (*)
Mr. José María Álvarez-Pallete López	192,000	300,000
Mr. Ángel Vilá Boix	120,000	187,500
Mr. César Alierta Izuel	324,000	506,250

(*) Maximum possible number of shares to be received in case of meeting the co-investment requirement and maximum completion of TSR target.
Mr. César Alierta Izuel ceased his position as Director on May 4, 2017.

In any case, it is clarified that no share has been delivered to the Executive Board Members under the second cycle of the PIP and that the previous box only reflects the number of potentially deliverable shares in different scenarios, without supposing in any way that they will effectively be delivered in whole or in part.

In effect, the number of Telefónica, S.A. shares that, always within the maximum established, could be object of delivery, when applicable, is conditioned to the Participants and is determined depending on the Total Shareholder Return ("TSR") of the Telefónica, S.A. share during the duration period of the cycle (3 years), with relation to the TSRs experienced by certain companies belonging to the telecommunications sector, weighted according to their relevance for Telefónica, S.A., that for the purposes of the Plan will constitute a comparison group (hereinafter, the "Comparison Group"). The companies included in the Comparison Group are listed below: America Movil, BT Group, Deutsche Telekom, Orange, Telecom Italia, Vodafone Group, Proximus, Royal KPN, Millicom, Oi, Swisscom, Telenor, TeliaSonera, and Tim Participaçoes.

The achievement scale approved by the Board is the following: in the event that the performance of the TSR of the Telefónica, S.A. share is located in, at least, the median of the Comparison Group, the number of shares to be delivered will be 30% of the maximum. For the case of said performance located in the third quartile of the Comparison Group, the number of shares to be delivered will be 100% of the maximum. Those cases that are located between the median and the third quartile will be calculated by linear interpolation. In the event that the TSR performance of the Telefónica, S.A. share is located in the ninth decile or above, the percentage to be delivered will be greater than 100%, up to a maximum of 125%, being calculated by linear interpolation between said third quartile and the ninth decile.

2. The second plan is the incentive plan for the purchase of Telefónica, S.A. shares. (2015-2017) directed to all the employees of the Group at the international scale (including leadership, as well as the Executive Board Members) called "Overall Incentive Plan for the Purchasing of Shares for Employees" ("GESP"), whose third edition was approved by the General Shareholder's Meeting of the Company held on May 30, 2014.

This Plan was aimed at strengthening the character of the overall employer of Telefónica, creating a common payment culture throughout the Company, promoting participation in the capital of the totality of the employees of the Group, and fostering motivation and loyalty.

Under this Plan, employees were offered the option to acquire Telefónica, S.A. shares during a maximum twelve month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements. Each employee was limited to buying a maximum of 1,800 euros in shares, subject to a minimum of 300 euros. If the employee remained part of the Telefónica Group and held onto the shares for one year following the acquisition period (the consolidation period), they were entitled to receive one free share for each share they acquired and retained throughout the consolidation period.

The Executive Board Members, Mr. José María Álvarez-Pallete López and Mr. Ángel Vilá Boix, and then Executive Board Member, Mr. César Alierta Izuel, decided to participate in this Plan 2015-2017 with the maximum contribution (that is, 150 euros monthly for twelve months), having each acquired a total of 357 shares (among which included those that they received for free, in accordance with that established in the general conditions of this Plan).

Additionally, it is worth noting that the external Board Members of the Company do not receive and have not received during 2017 any payment in terms of pensions or life insurance, nor participate in payment plans regarding the price value of the share (with the exception of that indicated for Mr. Alierta in the previous boxes).

Likewise, the Company does not grant and has not granted, in 2017, any advances, loans or credits in favor of the Board Members, nor in favor of their Senior Management, complying with the demands of the Sarbanes-Oxley Act published in the United States, and that is applicable to Telefónica as a company listed in that market.

Compensation of the Senior Management of the Company.

The Management that in 2017 included the Senior Management[1] of the Company, excluding those that form an integral part of the Board of Directors, received a total of 7,566,822 euros in 2017.

Regarding long-term savings systems, the contributions made on behalf of the Telefónica Group during 2017 to the Social Welfare Plan described in the note on "Income and expenses" in regard to those Managers amount to 874,796 euros; the contributions corresponding to the Pension Plan amount to 24,058 euros, and the contributions to Unit Linked Excess Insurance Pension Plan amount to 83,089 euros.

Likewise, the amounts relative to the payment in kind (among which includes, the quotes for life insurance and other types of insurance, such as general medical insurance and dental and vehicle coverage), have been 94,637 euros.

Moreover, and with regard to payment plans based on shares, during 2017 the following two long-term variable payment plans existed:

1. The one named "Performance & Investment Plan" ("PIP") composed of three cycles (2014-2017; 2015-2018; 2016-2019), approved by the General Shareholder's Meeting held on May 30, 2014. The first cycle of this Plan started in 2014 and concluded in October of 2017. In accordance with that established in its general conditions, the delivery of shares did not happen in the first cycle of the Plan (2014-2017), therefore no share was delivered to the Managers that participated in this cycle.

The number of theoretical shares assigned (without co-investment) at the beginning of the second cycle (2015-2018) to the group of the senior executives in the Senior Management of the Company and the maximum number of shares assigned[2] is 197,650 and 307,063, respectively.

In any case, it is clarified that no share has been delivered to the Executive Board Members under the first or second cycle of the Second PIP and that the previous box only reflects the number of potentially deliverable shares in different scenarios, without supposing in any way that they will effectively be delivered in whole or in part.

With regard to the third cycle of this Plan (2016-2019), the Board of Directors of the Company, following a favorable report from the Appointments, Remuneration and Good Governance Committee, resolved not to

[1] Senior Management being understood, for these purposes, those persons that implement, de facto or de jure, senior management duties reporting directly to the Board of Directors or Executive Committees or Managing Directors of the Company, including in any case the supervisor of Internal Auditing.

[2] Maximum number possible of shares to be received in the event of fulfilling the co-investment requirement and maximum compliance of the TSR objective.

execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

2. The second Plan is the ""Overall Incentive Plan for the Purchasing of Shares for Employees" ("GESP") (2015-2017), whose third edition was approved by the General Shareholder's Meeting of the Company held on May 30, 2014.

The Managers that have decided to participate in it with the maximum contribution (that is, 150 euros monthly for twelve months) have acquired a total of 1,429 shares (among which included those that they received for free, in accordance with that established in the general conditions of said Plan).

Management report 2017

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

Business Model

Telefónica is one of the world's leading communications services providers. Our objective is to create, protect and promote fixed and mobile connections for our customers helping them to take control over their digital lifestyle. Therefore, we primarily offer our customers the connectivity they need to interact and live in the markets where we operate through simple products and services while protecting their data and managing it in a responsible way.

The organizational structure approved by the Board of Directors of Telefónica, S.A. on February 26, 2014 is made up of the following segments: Telefónica Spain, Telefónica United Kingdom, Telefónica Germany, Telefónica Brazil and Telefónica Hispanoamérica (formed by the Group's operators in Argentina, Chile, Peru, Colombia, Mexico, Venezuela, Central America, Ecuador and Uruguay). These segments include the information related to wireline, wireless, cable, data, internet and television businesses and other digital services provided in each country or countries. Any services not specifically included in these segments are part of "Other companies and eliminations". Telxius' financial figures are fully reported under "Other companies and eliminations" since January 1, 2017, reflecting the integration within Telxius of the mobile telecommunications towers transferred from Telefónica Spain, Telefónica Germany, Telefónica Brazil and Telefónica Hispanoamérica (Telefónica Peru and Telefónica Chile) segments and the international submarine fiber optic cable (which had been previously reported under "Other companies and eliminations").

The Telefónica Group's strategy aims to:

Enhance value through:

- Offering good connectivity, for which our infrastructure management and our continuous investment in network are key. We aim to return control over the data to our customers.
- Providing a bundled offer with video and digital services. We offer our customers additional data in order to amplify services, such as video or digital services, through unique, simple and clear offers.
- Providing increased customer value and customer experience with improved digital access, aiming to offer the best products, solutions and contents.

With the following enablers:

- End-to-end digitalization: seeking the reduction of our legacy investments to increase virtualization, the reduction of physical servers, data centers and applications, the digitalization of IT systems and processes and the digitalization of front and back office, in order to be able to offer a true digital experience to our customers.
- Big data and innovation to add value to our customers and return the control over data to our customers.
- Continued focus on capital allocation in our legacy investments and the simplification of processes in order to continue investing.

Economic results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 554 million euros in 2017. Highlights of the 2017 income statement include:

- Revenue from operations, amounting to 3,715 million euros has been increased year on year, primarily due to the dividend distributions from Group companies and associates. In 2017, Telfisa Global, B.V. (733 million euros) and Telefónica de España, S.A.U. (664 million euros) have distributed dividends and these companies did not distribute dividends in 2016.

- The figure of “Impairment losses and other losses” amounting to write-off of 1,443 million euros in 2017 has changed its sign compared to 2016 due to the impairment charges of investments in Telefônica Brasil, S.A. and Sao Paulo Telecomunicaçoes, Ltda totaling 623 million euros (in 2016 there was a write down reversal of 3,196 million euros). In 2016 a write down reversal in Telefónica Latinoamérica Holding, S.L. amounting to 1,133 million euros was recorded and in 2017 no additional write-down have been booked.

- The impact of the sale of 40% of Telxius Telecom, S.A.U. is included under the caption "Gain on disposal of investments" for an amount of 313 million euros.

- Net financial expense totaled 1,733 million euros in 2017 (2,227 million euros of financial expense in 2016). This was mainly due to finance costs with Group companies and associates, principally from Telefónica Europe, B.V. amounting to 479 million euros (452 million euros in 2016) and Telefónica Emisiones, S.A.U. totaling 1,335 million euros (1,337 million euros in 2016).

Investment activity

2017

On February 10, 2017 Telefónica and Taurus Bidco S.à.r.l. (hereinafter“KKR”, an entity managed by Kohlberg Kravis Roberts & Co. L.P.) reached an agreement for the sale of up to 40% of the share capital of Telxius Telecom, S.A.U. in exchange for an aggregate amount of 1,275 million euros (12.75 euros per share).

The agreement envisaged a sale of 62 million shares of Telxius Telecom, S.A.U. (representing 24.8% of its share capital) for an amount of 790,5 million euros as well as a call option over additional 38 million shares (representing 15.2% of its total share capital) for a minimun price of 484.5 million euros.

On October 24, 2017, Telefónica announced that, after obtaining all the relevant regulatory approvals, it has transferred to KKR 62 million shares of Telxius with a profit of 191 million euros. On December 13, 2017 KKR exercised the call option foreseen in the agreement over 38 million shares of Telxius Telecom, S.A.U. in exchange for 484.5 million euros resulting in an income on the "Gain on disposals" caption of the income statement amounting to 120 million euros.

The Group is carrying out a simplification process of corporate structure and pursuant to this process several mergers by absorption have been completed in 2017. The net book value of the absorbed companies has been accounted for in the surviving company as an increase in its investment cost. Therefore the cost and the impairment provision of the absorbed investments have been reversed.

The merger transactions affecting 2017 investments are the following:

- In September 2017 Telefónica Latinoamérica Holding, S.L. carried out a merge by absorption of Telefónica Datacorp, S.A. and Ecuador Cellular Holding, S.L., which were both direct subsidiaries of Telefónica, S.A.

- On the same date, Telefónica Digital Holding, S.L.U. was merged and absorbed by Telefónica Digital España, S.L.U., and after this transaction the latter company becomes a direct affiliate of Telefónica, S.A.

- In November, 2017 Telefónica Móviles Argentina Holding, S.A. was merged to Telefónica Móviles Argentina, S.A. After this transaction the Company increased its direct ownership from 21.1% to 73.2%.

- In December 2017, Telefónica International Wholesale Services II, S.L. carried out a merge by absorption of Telefónica International Wholesale Services, S.L., which was a direct affiliate of Telefónica, S.A.

2016

Following the decision of the European Commission to prohibit the sale of Telefónica Europe, plc to the Hutchison Whampoa group, and as a consequence of the strategy approved by the Board of Directors of Telefónica at its meeting held on June 29, 2016, the investment in the company which was previously considered as a “Held for sale asset” was reclassified to the “Long Term investment in Group companies and associates” caption amounting to 12,501 million euros.

During the first semester of 2016, Telefónica decided to rearrange the assets related to infrastructures of the Group, including the telecommunication towers as well as the network of underwater and terrestrial optic fiber, unifying the concept within the same holding company (Telxius Telecom, S.A.U.). In the framework of this reorganization the following investing transactions have been made by Telefónica, S.A.:

- On January 29, 2016, Telefónica Internacional, S.A.U. sold at its net book value the 50% of its stake in Telefónica América, S.A. to Telefónica, S.A. After this transaction Telefónica, S.A. became the sole stakeholder of Telefónica América, S.A.U. On March 7th, 2016, the company’s denomination was changed to Telxius Telecom, S.A.U. Telxius Telecom, S.A.U. was thus designated to be the parent company of the rearranged group of the above mentioned infrastructure entities.

- On February 16, 2016 Telefónica Móviles España, S.A.U. carried out a partial split-off of Wireless Towers, S.L.U. (a newly-incorporated company renamed after as Telxius Torres España, S.L.U.) with the aim of placing in this new company the business line of ownership and exploitation of mobile phone towers. Telefónica, S.A. recorded the split-off transaction at book value of the assets (214 million euros)
- On March 28, 2016 Telefónica International Wholesale Services América, S.A. executed a capital increase of 187 million dollars fully subscribed and paid pro-rata by the shareholders. The transaction implied a disboursement of 122 million euros for Telefónica, S.A., included as "Additions" in the 2016 chart of movements. The funds were used to compensate prior years' negative reserves before the nonmonetary contribution of the company to Telxius Telecom, S.A.U. The contribution was completed on March 31 at its book value (448 million euros).
- On March 30, 2016 Telxius Telecom, S.A.U. made a capital increase of 1,450 million euros fully subscribed and paid by the Company. On May 27, 2016 an additional capital increase was carried forward amounting to 502 million euros, also fully subscribed and paid by Telefónica, S.A.
- On March 31, 2016, Telxius entered into a purchase agreement to acquire all the shares of Telxius Torres España, S.L.U. from Telefónica, S.A. at fair value (1,210 million euros). The profit of the transaction amounted to 996 million euros in the income statement of Telefónica, S.A.

Assessment of impairment of investments

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net debt), considering the percentage of ownership in each subsidiary and translated to euros at the official closing rate of each currency at December 31. Moreover, and only for the companies where discounted cash flow analysis is not available, due to the specific nature of their businesses, the impairment is calculated by comparing their Equity figure as of the end of the period and the net book value of those investments.

As a result of these estimations and the effect of the net investment hedge in 2017, an impairment provision of 1,443 million euros was recognized (write down reversal of 2,049 million euros in 2016). This amount derives mainly from the following companies:

(a) write down of 510 million euros for Telefônica Brasil, S.A. (reverse of the write down amounting to 2,491 million euros in 2016) and 113 million euros for Sao Paulo Telecomunicaçoes, Ltda (a reversal of 705 million euros in 2016).

(b) write down, net of hedges, of 460 million euros for Telefónica Europe, plc (582 million euros, net of hedges, in 2016).

(c) reversal of write down by 96 million euros for Telefónica México, S.A. de C.V. (write down by 1,264 million euros in 2016).

(d) In 2017 no write down has been recorded for the investment of Telefónica Latinoamérica Holding, S.L. In 2016 there was a reversal of the write down of 1,133 million euros booked in 2015, mainly due to the revaluation of the Brazilian Real which had a positive impact in the investments of 36.01% stake in Telefônica Brasil, S.A.

(e) write down of 177 million euros for Telefónica Contenidos, S.A.U. (11 million euros in 2016).

(f) write down of 93 million euros for Telefónica Digital Holding, S.L.U. (232 million euros in 2016). In addition, after the merger of the company with Telefónica Digital España, S.L.U., a write down of 48 million euros in connection with this last company has been registered.

Main hypothesis used for the calculation of the discounted cash flows of investments

Brazil has suffered in 2017 adverse macro-finance effects. Firstly, and most remarkable, the appreciation of the exchange rate has resolved into an decrease in the value of the assets nominated in Brazilian reales by 14%. Secondly, even if there is an ongoing improvement in the macroeconomic scenario and more favorable financial figures, Brazilian economy growth rate in 2017 has performed 1% below its target. Whereas tax balances have improved thanks to revenue increases, uncertainties about the economic sustainability in the long term still remain because key structural changes, such as the change in the Social Security system, which would have reinforced other changes such as the government expenditure ceiling, have not been approved. The operating income before depreciation and amortization (OIBDA) margin for Brazil is in line with the average of analysts' long term forecasts for the company, at approximately 37%. With respect to capex investments, the operator will invest a percentage in line with the investment needs identified by analysts (17%). Discount rate of 10.9% is slightly lower than the rate used in 2016 (11.3%), in line with the expectations of the analysts' consensus. The perpetuity growth rate for 2017 (4.5%) is 0.5 p.p. lower than the one used in 2016 and in line with analysts' consensus for the company. It is also consistant with the Brazilian Central Bank’s medium-term inflation target (4.5%, within a range of ±1.5 p.p.) and aligned with the analyst consensus for the Strategic Plan horizon (around 4%) and below the forecast nominal GDP growth rate (which oscillates around 7%). Therefore, a conservative outlook has been maintained in accordance with the analysts' expectations.

Mexican economy has behaved with fortitude despite an external complex scenario, mainly due to the growing interest rates in the United States of America and the uncertainty surrounding the North America Free Trade Agreement. The structural changes carried out in the last few years have been a turning point, solving some inefficiencies in the public and education sectors and as well as in the labor market. Within this scenario, the economic growth expectations have been increased, especially for private consumption. This magnitude has been growing around 3% on an annual basis boosted by the labor market with the lowest unemployment rate since 2006. This growth has enabled a tax deficit reduction with a primary surplus close to the figures achieved previous to the crisis. There has been an impact both in the financial markets and in the rating agencies. With respect to the financial markets, the country risk has dropped an average of 50 b.p.s. since 2016 and the volatility of the Mexican pesos exchange rate in 2017 has also been lower. As for the rating agencies, both Fitch and S&P raised their perspectives on Mexico to stable. On the other hand, offsetting the improvements in the macroeconomic scenario, in the telecommunication markets and in the mobile phone market in particular, there is still a great difference between the incumbent operator and the rest its competitors. The share of the incumbent operator is still higher than 65% in the wide bandwidth and cell phone markets in terms of total active accesses despite the change in the sector regulation carried out by the government in order to increase competence and allow the entrance of new operators in the market.

With regard to the United Kingdom, the long-term OIBDA margin for operations (24%) is within the range of the analysts' consensus. With respect to the ratio of CapEx over revenues, over the term of the strategic plan, in United Kingdom the ratio of invest at a percentage of revenue is aligned with analysts’ estimations (around 13%). The discount rate (6.3%) is considered to have greater market risk, due to the increase in uncertainty of British equity securities as a result of Brexit, however, this risk is in line with the estimates given by analysts. Accordingly, the currency which is the main variable used for external adjustments because of its great commercial dependence on Europe, has suffered a 4% depreciation against euro since 2016 (comparing year-end to year-end), and therefore a negative impact in the British net assets and cash flows nominated in euros. In the United Kingdom the perpetuity growth rate is a 1.7% showing a slight slowdown since 2016 caused by the negative effect of the inflation rate growth in the British consumers' purchasing power.

Share price performance

Global growth remained solid in 2017 and surpassed expectations for the first time since 2010. With regards to monetary policy, the ECB maintained marginal lending facility rate stable throughout the year at 0.25%, but announced in October its intention to reduce the Asset Purchase Programme. In the US, on the one hand, Federal Reserve's Federal Open Market Committee increased interest rates 3 times in the year from 0.75% to 1.50% and balance sheet normalization started in October while progress on the fiscal agenda gained speed, most notably on tax reform. On the political front, the focus was on Dutch, French, and German elections as well as negotiations over Brexit between Brussels and the UK, while in Spain the agenda was marked by separatist events in Catalonia that led to regional elections in December. On the geopolitical front, tension between the US and North Korea escalated.

In this context, the main European indexes closed 2017 with a positive performance (EStoxx-50 +6.5%); DAX (+12.5%), CAC-40 (+9.3%), FTSE-100 (+7.6%), and Ibex-35 (+7.4%).

Among sectors included in the European DJ Stoxx-600 (+7.7%), technology (+19.2%) and basic resources (+19.2%) led positive performances, whereas only 4 sectors posted negative performances, being the worst telecommunications (-3.7%). The performance of the telecommunications sector was affected by adverse regulatory drag, reflected in weak revenue growth trends. Regulation also affected negatively the limited M&A activity in the sector, as well as the visibility on the profitability of the required investments for the Digital society.

Telefónica share closed 2017 at 8.13 euros per share, -8.1% in the year but the total shareholder return was -3.8%, following a dividend distribution of 0.40 euros per share in cash. The sector in Europe posted a total shareholder return after dividends of 0.7%. The performance of Telefónica was impacted in the second half of the year by the adverse evolution of exchange rates affecting earnings momentum and the political developments in Spain.

Telefónica closed the 2017 financial year with a market capitalization of 42,183 million euros, ranking as the twelfth company in the telecommunications sector worldwide.

Research, development and innovation

Telefónica remains committed to technological innovation as a fundamental tool for being one of the main actors in the new digital universe, with the capacity to help to create a more sustainable world while achieving competitive advantages and distinctive products. By introducing new technologies and developing business solutions and processes, we aim to become a more effective, efficient and customer-oriented Group.

Telefónica bases its innovation strategy on the balance between two main models:

- Promoting our internal research, development and innovation (R&D&i) capabilities, for which we have developed our own innovation model, which allows us to promote the application of technical research in developing commercial products and services using the knowledge developed in research centers, technological institutes and universities, among other sources; and

- Promoting the creation of open innovation ecosystems, in which the **"Open Future"** initiative stands out as a global program designed to connect entrepreneurs, start-ups, investors, venture capital funds and public and private organizations around the world which promote innovation in collaboration with other actors.

In parallel with these two models, Telefónica seeks to promote the development of sustainable solutions that generate a positive impact on the environment and on the economic, social and technological progress of the regions in which we operate. To this effect, in addition to the investment made in promoting sustainable innovation projects and in the activities that are developed to guarantee the accessibility of our solutions to all groups, Telefónica has a subsidiary focused the development of disruptive technologies.

Telefónica firmly believes that competitive advantage cannot be based solely on acquired technology, and so has always considered the promotion of internal innovation, research and development activities as a strategic axis, in an effort to achieve this differentiation and move forward in other activities which guarantee the sustainability of our business.

To this effect, the Telefónica Group's internal innovation policy focuses on contributing with solutions that support Telefónica's commitment to developing a responsible business under the criteria of economic, social and environmental sustainability, by:

- Developing new products and services that enable growth and competition in an increasingly global environment, while being adapted to the diversity and local needs of each market;

- Encouraging the return of innovation through open innovation and creating value from the technology generated;

- Increasing our customers' loyalty and satisfaction;

- Increasing the revenues, profits and value of the Company;

- Increasing the quality of our infrastructure and services, as well as our relationship with our technology providers and solutions; and,

- Improving business processes and operations with the aim of optimizing resources, increasing efficiency and reducing environmental impact.

During 2017 we carried out numerous technological innovation projects focused on sustainability, process efficiency, the creation of new sources of revenue, customer satisfaction, the consolidation of our presence in new markets and technological leadership.

We also develop innovation projects to promote an increase in the access to information technology in country areas or areas of difficult access (Proyecto Internet para todos), new connectivity technologies, solutions and applications focused on Internet business models, advanced user interfaces, distribution of TV and multimedia contents and other value added services, taking advantage of the potential of the telecommunications infrastructures deployed. These projects, among others, were undertaken based on our objective to quickly identify emerging technologies that may have a relevant impact on our business, and to test these technologies on pilots related to new platform services, applications and prototypes.

A significant part of the innovation activities and projects of research, development and innovations are carried out by the Innovation department of Telefónica, which receives support from other companies and universities in the execution of its functions. Its mission is focused on improving our competitiveness through technological innovation and product development. Additionally, it is also responsible for experimental and applied research and for the development of products to increase our range of services and reduce operating costs.

The technological innovation activities of Telefónica are focused on three main areas:

1. The development of new networks. These activities are related to new radio and fibre optic access technologies (technologies on the virtualization of network functions, in line with the technological trend known as SDN or defined networks via software) and on topics related to network optimization, which enable us to have a much more flexible and adaptable network that is dynamically adaptable to the new requirements of digital services and customers.This category also encompasses all innovation activities with a purpose of efficiently deploying the network in remote and difficult-to-access areas to bring services that offer connectivity to the entire population. This project provides connectivity to rural populations through innovative technologies including yet not limited to integration with satellites, flight networks, microcells and network virtualization functions.

2. The development of new products and services which are carried out within the framework of the digital services strategy. The following stand out among these activities:

    - Interpersonal communication of the future with natural access, taking advantage of the possibilities of the Internet and smartphones;

    - Services related to Big Data, regarding the concept of the Fourth Platform, whose vision is to return the value associated with the data it generates to the customer;

    - Video and multimedia services (combining text, audio, images and video) with a user experience on all connected devices;

    - Advanced solutions in emerging ICT businesses, such as *cloud computing* cloud or security;

    - Management of Internet of Things (IoT) services, related to enriched mobility, energy efficiency and smart retail;

3. Experimental and applied research: With a medium and long-term outlook, Telefónica also has **“Scientific Groups”** whose mission is to investigate the possibilities of new networks and services and to solve the technological, social and environmental challenges that arise.

It should be noted that in 2017 consolidation was made of the Telefónica Alpha Innovation unit, which was conceived to focus on innovating products and developing disruptive technologies that address the main challenges affecting the planet and society. In addition, Telefónica I+D Chile, a 100% subsidiary of Telefónica Chile, which was launched in 2014 in collaboration with the Chilean government, continues developing products and generating patents in "enriched mobility", Smart Industry and Smart Agro.

The total R&D expense in the Group for 2017 amounted to 862 million euros, 4.8% less than the 906 million euros incurred in 2016 (1,055 million euros in 2015). This expense represents 1.7%, 1.7% and 1.9% of the Group’s consolidated revenue for 2017, 2016 and 2015, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

During 2017, Telefónica registered 32 new patent applications, including two through the American office (USPTO), four through the Chilean office (INAPI) and 26 through the Spanish patent and trademark office (OEPM), 25 of which were European applications and one was an international one (PCT). Moreover, 8 industrial designs with European scope were registered through the OEPM.

Regarding the development of open innovation in Telefónica, the company has the Open Future unit, which includes an open, global program designed to connect entrepreneurs, startups, investors, and public and private organizations from around the world.

The main objective of Open Future_ is to detect, develop and enhance the talent and technological entrepreneurship in the local ecosystem of the 17 countries in which it is present and in all its phases, for that which drives and accelerates the growth of ideas, projects, initiatives and companies. The integral character of Telefónica Open Future enables innovation to be developed in different stages. It is structured around six initiatives, the objectives of which are as follows:

- **Drive** (Think Big and Talentum Startups).
- **Accelerate** (Crowdworking and Wayra).
- **Invest** (Telefónica Ventures and the Amérigo Funds).

Telefónica Open Future, ended 2017 as one of the main investors in the Spanish area of open innovation, positioning itself as one of the major funds in Europe and Latin America in venture capital investment, thus positioning Telefónica as one of the most innovative companies, as also recognized by the Startup Europe Partnership, a European Union platform, appraising the company as the second largest European company to support innovation.

Non-financial information

With a view to improving the consistency and comparability of non-financial information reporting, Telefónica presents a non-financial information statement containing information regarding environmental, social and personnel matters, respect for human rights, anti-corruption and bribery, and diversity management. Pursuant to Spanish Royal Decree-Law 18/2017 of 24 November, this statement includes insight into the results of the policies and risks linked to these matters.

The non-financial information statement includes information regarding due diligence procedures applied by Telefónica and in relation with its supply and subcontracting chains for the purpose of detecting, preventing and mitigating existing and potential adverse effects.

Since 2002, Telefónica has been reporting thorough and externally-reviewed information on its non-financial indicators according to comparable international standards of the Global Reporting Initiative (GRI) in its Annual Report and, since 2016, the company's Management Report includes a material and accurate summary of these indicators.

Sustainability and Responsible Business

Introduction

The future of Telefónica will pass through fostering a responsible business model, capable of cultivating the **trust** of our customers, investors, employees, shareholders and society as a whole. To do so, we have the Global Responsible Business Plan, approved and tracked by the Board of Director's Regulation and Institutional Affairs Committee.

This Plan sets out the priorities until 2020 into three subjects: compliance and risk management, responsible productivity and sustainability as a leverage for growth to improve our business and the world.

The plan is presently based on Corporate Ethics, **Customer Promise, Digital Confidence**; **Responsible Supply Chain Management**; **Talent and Diversity Management**; **Environmental Strategy, Human Rights, Social and Tax Commitment and Sustainable Innovation**, with their corresponding objectives and KPIs. It is further specified in different local plans in the countries where we have activities.

Risks: Through the Integrated Assurance and Risk Management Model, implemented consistently in the main operations and transactions of the Group, we conduct a biannual tracking of the material risks of the group. This model considers methodology benchmarks such as yet not restricted to “Enterprise Risk Management - Integrated Framework” issued by COSO or standard ISO 31000. All personnel within the organization have the duty to contribute to risk management. The Board of Director's Audit and Control Committee supervises the risk management system, which identifies the categories of risks that the company faces, defines the acceptable risk level, measures for mitigating the impact of the identified risks, and also the control and information systems for controlling and managing these risks.

In terms of sustainability, the Integrated Assurance and Risk Management Model (IARM) incorporates a series of specific categories, which could be compliance risks, environmental risks, responsible supply chain management, privacy and security. Additionally, sustainability aspects will be considered when assessing other business categories, which could include business or customer continuity.

Responsible Business Principles: Telefónica's Responsible Business Principles are the foundation of the company's code of ethics; they define how we interact and the ethical commitments we undertake with our stakeholders: customers, employees, shareholders, providers and society in general. Our Principles reflect the ethical standards that we must apply in all our actions, our commitment to human rights, our promise to our customers, respect for privacy and freedom of expression, security, responsible communication and our commitment to the environment and to society in general. All these principles are set forth in greater detail through internal policies and regulations that apply to all Group employees. In addition, the company promotes employee knowledge of and compliance with these Principles by conducting a mandatory course and internal communication campaigns throughout the year

Fight against corruption and bribery

The total commitment of the Telefónica Group in the fight against corruption and bribery and in general, in relation to the regulatory compliance, led to the approval by the Board of Directors of Telefónica, S.A. of the creation of an independent compliance area on December 16, 2015, as well as the subsequent appointment, in February 2016, of the Chief Compliance Officer of the Telefónica Group; the objective was to continue, in an even more focused manner, with the implementation of a compliance model at Telefónica, notwithstanding all the activities carried out up to that date by other company areas to prevent corruption and bribery (internal audit area, sustainability area and legal area).

Additionally, although the Compliance function covers and supports any issue related to its function that may arise in respect of certain matters identified as sensitive from a Compliance point of view (privacy, anti-trust, security, tax, regulatory, etc.), the main subject matter overseen by the Compliance area and on which its main policies, procedures and controls are focused on, is the integrity matter, matter that includes the corruption and bribery issues.

With regard to the evolution of the Compliance function, it should be outlined that throughout 2016 and 2017, a total of 15 local Compliance units were created in those countries where Telefonica Group has its main operations (apart from those Compliance areas already existing in UK and Germany operating businesses). The development of the Compliance local units has contributed to the reinforcement of the Compliance culture at Telefónica.

In relation to the policies and procedures implemented in the Telefónica Group against corruption and bribery, including the risk assessment procedures, the following should be highlighted, among others:

- specific internal rules, including, as the most significant one, the Anti-Corruption Policy.
- channel where the queries related to the anticorruption claims can be resolved.
- compliance third party due diligence.
- criminal prevention model (in Spain and in other jurisdictions depending on the applicable law).
- Preventive Control Procedure that includes, in respect of each subject matter (including the integrity matter), the identification of the key obligations, the relevant control model about those obligations, the subsequent risk assessment (in the context of the global risk map) and if applicable, the identification of the relevant action plans.
- awareness and training: Telefónica has in place different mandatory courses related to the integrity matter, some of them specifically related to the anticorruption matter.
- Whistler-blower channel and conflict of interest reporting tool.

Finally, with regard to the risks about corruption and bribery matters, Telefónica Group is exposed to risks related to the compliance of the law against corruption and economic sanctions programs as it is explained in the “Risk Factors Associated with the Issuer” chapter.

Customer Promise & Digital Confidence

- Risk Analysis: Through IARM categories referred to as: “Customer Mindset Adaptation”, “Customer Satisfaction”, “Responsibility with the Consumer”, “Product and Service Marketing and Commercialization”, “Data Privacy”, “Security Systems” and “Cybersecurity”, a suitable control on customer-related risks is carried out.
- Policies and indicators: There are multiple policies and initiatives implemented for managing these risks at the company, the most important are:

- Global “Customer Promise” project for reinforcing the relationship of trust that we have with our customers, not only in the commercial area, complying with some standards of transparency and honesty, but also within the scope of privacy and security.
- Global courses in privacy and security.
- Global Security Policy and every security regulation contained therein.
- Global Privacy Policy.

- Results and indicators of the policies and initiatives

  A sample of results and indicators related to these policies and initiatives is on the following table listing non-financial indicators. A more comprehensive sample of relevant indicators will be published in the company's 2017 Integrated Report under the Global Reporting Initiative (GRI) Standards.

Sustainable supply chain management

- Risk analysis: Through IARM categories referred to as: “Sustainable Supply Chain Management”, “Key Vendor Concentration and Dependency” and “Third-party Management” a suitable control is carried out on the risks related to Sustainability in the Supply Chain.
- Policies and indicators: There are multiple policies and initiatives implemented for managing these risks at the company, the most important are:
  - The general terms and conditions for purchasing goods and services
  - The Policy and Standard for Sustainability in the Supply Chain
  - The assessment of vendors of greatest risk based on different assessment and auditing methodologies accompanied by the implementation of improvement plans such as Ecovadis, Aliados and the Joint Audit Committee. Indicators: number of high-risk vendors, number of assessments or audits conducted on high-risk vendors; number of vendors with improvement plans.
- Results of the policies and initiatives

  A sample of results and indicators related to these policies and initiatives is on the following table listing non-financial indicators. A more comprehensive sample of relevant indicators will be published in the company's 2017 Integrated Report under the Global Reporting Initiative (GRI) Standards.

Environmental Strategy and Climate Change

- Risk Analysis

  Telefónica's environmental and climate change risks are controlled and managed under the company's global risk management model.

  The environmental aspects of Telefónica have their greatest risk in the wide geographical breadth of its infrastructures, which is controlled through environmental management based on uniform processes that are certified according to ISO 14001.

  The risks arising from climate change are physical risks that could have a greater impact on the company, particularly the ones arising from extreme weather events and the global warming, which could result in greater needs for cooling. To control this second risk, the company has a global energy efficiency program and a renewable energy plan. For managing extreme weather events, Telefónica has programs to enhance the resiliency of its network and improve the company's capabilities for adapting to climate change and mitigating the risks arising in this regard, considering them in network design and operation. Moreover, the company has business continuity plans for such events in the geographical regions requiring them.

- Policies and initiatives:

Telefónica has a Global Environmental Strategy, conceived from the Environmental Policy and Energy Policy approved by the company's Board of Directors. This strategy lays out a roadmap for the company to reach a green economy, reducing the environmental impact of its facilities while growing the potential of digitization to meet the major environmental challenges of other sectors.

Environmental management: Ninety percent (90%) of the company presently has Environmental Management Systems (EMS) that are ISO 14001 certified by an external entity. These systems contribute to the suitable management of the company's environmental aspects and extend a culture of environmental responsibility throughout the value chain. Telefónica's intends to have ISO 14001 certification of 100% of its operators.

The environmental impact affects our network the most because of its energy consumptions, but also in relation to physical elements with a visual impact or waste. For responsible network deployment and maintenance, Telefónica has common standards (rules, regulations and policies) for all our companies that go beyond existing legislation in force and comprise the principle of precaution and establish the minimum environmental management guidelines with a view to minimizing the impact of infrastructures, e.g., in the context of air pollution, waste and noise. We also extend compliance to these standards to our vendors (suppliers and providers) and contractors. Turning to water consumption, we foster initiatives for more efficient usage, particularly in regions with an elevated water stress.

Climate Change and energy: Climate change is one of the most important challenges that our society has ever faced. In this regard, progress in decarbonization, the detachment from economic growth and greenhouse gas emissions, has become urgent. Telefónica is aware of its potential role in finding solutions to climate change through digitization, but also of the responsibility that we must assume in reducing our individual carbon footprints.

With this goal in mind, 9 years ago we created a Global Climate Change Office. In 2016, we announced new Energy and Climate Change targets for 2015-2020, which not only are compatible with the expansion of the network and service quality but will also help us be more competitive:

- Reduce energy consumption per traffic unit by 50%.
- Commence uncoupling of our growth from greenhouse gas emissions, decreasing them by 30% in absolute terms by 2020 and 50% by 2030.
- Save €90 million through energy efficiency projects.
- Commit to renewable energies as sustainable sources for our business, using 50% of the electricity from renewable energy sources by 2020 and 100% by 2030.

To achieve these targets, the company has a global energy efficiency program and a renewable energy plan in place.

Circular Economy: The company is aware of the immense opportunities linked with the circular economy. In this regard, we promote reuse and recycling above other waste and used equipment management alternatives; implement low-carbon purchasing criteria and buy increasingly more efficient systems; consider the lifecycle analysis when designing customer products and increase information to customers through Ecorating; and also explore new business models for cultivating this philosophy with the use of IoT as a foundation.

Green Services: in the current context, where environmental challenges affect society as a whole, increased digitization now provides us with solutions related to climate issues, biodiversity, water and waste. We are aligning our business and environmental strategy, seeking to capture the opportunities linked to the search for solutions for our customers. We want to position ourselves as a key actor in the green economy and, in this regard, sustainable innovation is essential.

- Results and indicators of the policies and initiatives

  A sample of results and indicators related to these policies and initiatives is on the following table listing non-financial indicators. A more comprehensive sample of relevant indicators will be published in the company's 2017 Integrated Report under the Global Reporting Initiative (GRI) Standards.

  The following results are particularly salient from this past period:

  - We made progress in achieving our energy and climate change targets.
  - We certified the energy management systems for our operations in Spain and Germany according to ISO 50001.
  - We validated our greenhouse gas emission goals through the Science Based Initiative.
  - We made progress in our renewable energy plan and joined the RE100 initiative
  - We extended the Eco Rating initiative, a seal informing our customers of the environmental and social impact of mobile devices in 8 countries.
  - For the fourth straight year, we made the "A List" of the Carbon Disclosure Project, the largest climate change investment index.
  - We launched a platform for digitizing company waste management.
  - We certified Telefónica Brazil according to ISO 14001.
  - We furthered the Telefónica climate change adaptation strategy.

Talent management

- Risk Analysis

  Talent management is a basic aspect of the Telefónica Responsible Business Plan, since the present digital revolution entails the creation of new types of work with new digital skills that will have a decisive influence on the future competitiveness of the Company. Additionally, talent management at Telefónica is directly related to diversity management, since it is an important source of talent and a competitive element that brings us closer to a diverse and ever-changing society.

- Policies and initiatives

  At Telefónica, we want to guarantee the key profiles for the future. A Business Intelligence project has enabled us to identify differential capabilities to ensure success in technological disruption environments: learning capacity; ability to transform in constant change; and amplitude and depth of digital experiences.

  The Human Resources chapter of this report contains more information in this regard.

- Results and indicators of the policies and initiatives

  The following table of non-financial indicators includes the main talent management policy indicator: training hours of employees in the period. A more comprehensive sample of relevant indicators contemplated in the Global Reporting Initiative (GRI) Standards will be published in the company's 2017 Integrated Report.

Diversity

- Risk identification

  At Telefónica, diversity management is a key driver in digitizing the Company. Going beyond compliance with legislation, we see diversity as a source of talent. We therefore incorporate it as a key competitive element in our business model that brings us closer to a diverse and ever-changing society. Diversity cultivates empathy and innovation, and, as such, generates value for the company and positively affects our results.

Assuring our capacity to attract, retain and perceive value from the best talent is a fundamental piece in our business plan, which is closely linked to the creation of inclusive work environments in which the singularity of beliefs, backgrounds, capabilities and lifestyles help us make better corporate decisions. The challenge lies in going from theory to real and concrete application in the organization. Embracing the different dimensions of diversity from a comprehensive perspective will ensure successful internal consistency and preclude diversity management based on unintegrated initiatives. To do so, in addition to the gender dimension, at Telefónica we address other key dimensions of diversity such as disability from a point of view that goes beyond HR management. In this regard, we work to become a fully accessible company committed to making products and services that are accessible for persons with disabilities. For example, the free service Movistar+5S is particularly prominent as it lets persons with sensory impairments gain access to Movistar+ premium contents (films and series).

Created in 2016, the Diversity Board is a space for detecting risks, sharing good practices and replicating the initiatives with the best results in other countries.

At Telefónica, we understand Diversity not only as a matter of human resources management, but also as an opportunity to draw nearer to our customers, encouraging us to design and implement products and services that can be accessed by individuals with disabilities or any other personal condition.

- Policies and indicators

In response to this vision in 2017, we appointed a Chief Diversity Officer for expanding and deepening the strategic vision of diversity at Telefónica. Moreover, the structure and operation of the aforementioned Diversity Council Global was consolidated during 2017. The Diversity Council comprises members of the executive operating committees and was conceived to follow the Global Diversity Policy, approved in 2016, and for supporting the initiatives being developed locally.

We ensured the implementation of the Global Diversity Policy by incorporating diversity policy tracking into the Responsible Business Plan approved by the Board of Director's Regulation and Institutional Affairs Committee with a view to achieving progress toward our goals, particularly to have 30% female executives by 2020.

It is essential to also mention that the Company Executive Appointment and Dismissal Policy approved by the Executive Committee guarantees the best talent for the Company through meritocracy, diversity and transparency.

Telefónica, S.A. also has a Diversity Policy regarding its Board of Directors to ensure that motions to appoint and reelect Directors are based on a prior analysis of the needs of the company's Board of Directors, favoring the diversity of knowledge, education and professional experience, age and gender, without any implicit bias that would imply discrimination based on gender, disability or other personal condition.

- Results and indicators of the policies and initiatives

The number of employees at Telefónica as of 31 December 2017 was 122,718. Total female professionals grew to 46,224 (37.7% of the total) and the total male professionals tallied 76,494 (62.3% of the total). The percentage of women is 21.5% in management. It should also be mentioned that Telefónica's professionals hail from over 24 countries (four of which are represented in the Board of Directors) and pertain to over 100 nationalities. A more comprehensive sample of relevant indicators will be published in the company's 2017 Integrated Report under the Global Reporting Initiative (GRI) Standards.

The Appointment, Remuneration and Good Governance Committee and the Board of Directors of the Company are further proof of the company's commitment to a diverse Board of Directors, as reflected in the motions for appointment, reelection and ratification of Directors analyzed and approved in 2017, particularly in the motion to appoint Carmen García de Andrés, approved by the General Shareholders' Meeting on 9 June 2017.

Telefónica places the Diversity project among its strategic projects within the Responsible Business Plan presented and approved in the Regulation and Institutional Affairs Committee, which is chaired by Ignacio Moreno Martínez, CEO of the company.

Salary differences in executive posts. The statistical sample of the executive category by country is much smaller than top and middle level management categories and thus could present distortions due to the types of change and strong typical deviations in the analysis of means by gender in such small sample sizes (primarily because of the impact of personal factors such as age, years of experience, specific qualifications, continuous performance and seniority).

At Telefónica, remuneration packages for executives are established based on the following principles:

1. Comparing position by position with the market through the external service provider Willis Towers Watson.

2. Annual internal equity analysis to ensure a solid governance model.

3. Basing our salary review policies on the principle of performance.

4. Rewarding our executives for the value that they bring to the business, their experience, special skills and expertise, knowledge and years of experience, etc..

The Appointments and Remuneration Committee of the Board of Directors ensures that remuneration packages are drawn up according to the principles mentioned above.

Regarding point 1, here is an analysis of remuneration in comparison with local market data:

	Total compensation versus locals markets-Collective manager		
	Men	Women	Total
Above market	24%	18%	23%
At market	64%	77%	67%
Below market	12%	5%	10%

Human Rights

- Risk analysis:
- An assessment was made in 2013 regarding the potential impacts of our activities on Human Rights, following the UN Guiding Principles on Business and Human Rights. The assessment was conducted in 16 countries and addressed 15 subjects. As part of our due diligence, we have updated our assessment which is still ongoing, to review the most important impacts of our business and any human rights that may be affected, taking into consideration the development of our strategy and that of technological transformation.
- Policies and initiatives:
    - Commitment to the UN Guiding Principles on Business and Human Rights.
    - Policies addressing Human Rights such as the Global Privacy Policy, Global Security Policy, Global Diversity Policy, Sustainable Supply Chain Policy, etc.

- Analysis of the impact of the company's activities on Human Rights according to the UN Guiding Principles on Business and Human Rights and the corresponding action and mitigation plans.

- Responsible Business Channel, through which any interested individual or entity can make a query or complaint regarding Human Rights or any other matter regarding sustainability.

– Results and indicators of the policies and initiatives

  - A sample of results and indicators related to these policies and initiatives is on the following table listing non-financial indicators. A more comprehensive sample of relevant indicators will be published in the company's 2017 Integrated Report under the Global Reporting Initiative (GRI) Standards.

Engagement with the communities

Network deployment entails a process involving communication with stakeholders (owners, communities, authorities) which must be attended. Establishing a suitable dialog procedure with communities is one of Telefónica's main concerns.

At Telefónica there are internal procedures for dialog with the communities which establish an orderly plan. Among the best practices is to inform the community near the site where a telecommunication infrastructure construction project is to be carried out in Ecuador, the training of interlocutors from the academic world in Venezuela, cooperation and alignments of the sector through the associations which represent us in the different countries, the Codes of Good Practices for the Deployment of Mobile Communication Infrastructures in Argentina, or the communication programmes aimed at communities which demand coverage but reject aerials in Peru and Colombia.

Social commitment

– Risk analysis

– Access to high-speed bandwidth networks is the base of developing the digital economy. In this regard, as a connectivity provider, Telefónica aims to reach a growing number of people and thereby secure an essential role as catalyst in the digital transformation. A steadfast resolve for digital inclusion of marginalized social groups is essential to improve the environment in which Telefónica should further develop its business while generating a society with greater equality of opportunities.

– Policies and indicators

– Digital inclusion, which could be defined as an expanding global connectivity and adoption of Internet services, has proven to be not only capable of bringing social and economic benefits but also fertile with potential in the fight to reduce poverty, manage social and natural emergencies, improve community infrastructures, and even increase the offer of access to services, including healthcare, education or financial services.

– In the past decade, thanks to the investment in network deployment and new business models, we have been able to extend the coverage of our services with an accelerated reduction in the digital gap.

– Despite all the advances, however, there are still barriers to digital inclusion that leave behind unconnected and unattended communities to run the risk of even greater marginalization in addition to losing a golden opportunity for growth and development in these sectors of the population.

– For this reason, we believe that the solution to reduce this gap should be comprehensive and include private companies, authorities and the public sector. This is one of the main challenges we are facing in the coming years, for which we will succeed, since we have already begun to work on various fronts that will help us progress in the communities where we work, namely:

  - Network deployment in remote areas

    - Emergency response
    - Local digital education projects
    - Guarantee of accessibility to our products and services

- Results and indicators of the policies and initiatives

    - A sample of results and indicators related to these policies and initiatives is on the following table listing non-financial indicators. A more comprehensive sample of relevant indicators will be published in the company's 2017 Integrated Report.

Tax Commitment

Our Responsible Business Principles group a set of guidelines guiding us in our daily activities and define how to develop our business. In accordance therewith, at Telefónica we are committed to honesty and respect for the law in all our engagements regarding the handling of our tax matters.

In this regard, our tax policy comprises the following engagement guidelines:

- Compliance with all required tax obligations in all countries in which we operate, contributing to its economic and social progress, and reconciling our commitment to creating value for our shareholders through the efficient management of the costs associated with tax management.
- Commitment that all tax position assumed corresponds to commercial and business considerations. In this regard, the tax-related component of all transactions may not be justified independently from the commercial and business considerations that justify the corresponding operation.
- Appropriate documentation with a clear explanation of the adopted tax positions.
- Efficient tax management procedure ensuring correct tax statements.
- Tax-related risks are managed with a view to preventing and reducing tax disputes to be engaged only when necessary to achieve the tax strategy of the company.
- Management of the tax-related risks arising from interaction with the business. A comprehensive analysis of the corresponding tax aspects will always be carried out for commercial decision-making. When there are various tax alternatives to achieve the same objective, the company will opt for the most efficient in terms of taxation.
- Transfer price policy for all transactions between related parties and entities for guaranteeing the creation of value through functions, assets and the assumption of business-related risks.
- Effort and commitment to adapt the tax situation affecting Telefónica's reality to the new digital economy molding the current marketplace.
- A strong relationship with tax authorities. In this regard, originally through a decision by the Board of Directors, Telefónica, S.A. has been adhered to the Code of Good Tax Practices since 2010. This code was created by the Large Businesses Forum together with the Spanish Tax Administration with a view to preventing the use of opaque structures for tax purposes. Telefónica also participates in several international forums existing for fostering and developing the recommended good practices of the OCDE.
- Not using corporate structures for the purpose of hiding or reducing the transparency of company activities from tax authorities or other stakeholders. Moreover, and in accordance with the LSC, the creation or acquisition of stock in special purpose entities or companies domiciled in countries or regions considered to be tax havens, and any other transaction or operation of a similar nature that, for its complexity, could undermine or interfere with the transparency of Telefónica, is reviewed and, where pertinent, approved by the company's Board of Directors. Likewise, the approval of investments

or transactions of any sort that could entail a special tax-related risk given their elevated amount or special characteristics, will likewise be approved by the Board of Directors.

- Commitment not to have any presence in any of the jurisdictions listed as tax havens by the regulations established in Spain. If there is any business need to have an operator in a region listed as a tax haven, approval will be requested from the Board of Directors. The activities of the Telefónica Group in regions considered by other organizations as having little or no taxation structure will respond solely and exclusively to a business purpose and have the material and human resources necessary to undertake such activities without their purpose of transferring profit to these jurisdictions to secure a reduction in taxes in any case whatsoever.

- We ensure transparency in our financial reporting for investors and the company, and work to simplify an understanding of our tax-related matters.

In 2017, our total tax contribution totaled 12,188 million euros (3,327 million euros as input taxes and 8,861 million euros as charged taxes), which means that for every 100 euros of turnover, 23.4 are allocated to pay taxes (6.4 for input taxes and 17 for charged taxes).

Human Resources

Objectives and policies

At Telefonica we know that everything has to do with people, because, it is only through them that we can lead the transformation and undertake great challenges. From HR, we work hard in developing the potential of our employees so that they can fulfill the commitments established with our customers.

Our vision is based on four main pillars:

- Build talent and skills for business transformation.
- Promote simplification and ensure execution in the same way, creating in such a way, a simple organization with agile processes.
- Build a culture centered on the client, always through the collaboration of diverse work teams.
- Become a 100% online area with a high degree of self-service in the internal processes of human resources, relying on shared services and providing an integrated human resources experience for managers and employees based on empowerment.

Within the framework of our Transformation Programme "We choose it all", there is a priority in the business: The digitalization, and from Human Resources we support this strategy with the digitalization of our processes. We mainly rely on SAP SuccessFactors, a leader in cloud solutions, to integrate in a single global tool the recurrent processes for the employee such as training, recruitment, performance, compensation and personnel management, promoting self-management and multi-device access from anywhere and anytime.

As of today, 120 thousand professionals in 40 countries and 177 entities have a global employee experience. Despite its youth, SuccessFactors already shows some adoption data that point to the great acceptance by our employees: in the last year, 3 million accesses to the system, 4,9 million hours in on-line courses, 100,000 acknowledgments among colleagues and 33,000 members in knowledge communities. This is a clear example that Telefónica is on the right track of simplifying and digitizing its forms of work.

Employee Training

At the point of transformation in which Telefónica S.A is today, as well as the rest of the Group Companies, the training and learning of people is a decisive and strategic element of which we are completely responsible.

In 2017, the global training model (single access through SuccessFactors) has enabled real-time learning through SAP JAM, as well as the generation of synergies between collaborators from different countries and companies in the group. This has given a variety of information whilst looking for ways to develop the efficiency of training. Likewise, the model seeks to achieve a culture of self-service, in which people take responsibility for their training without needing more participants than themselves.

Universitas has continued with a series of programmes, both on a virtual and face-to-face level. In this last modality, almost 2.000 people have received in the physical campus of Barcelona in regular programmes and more than 1.000 in external programmes, designed for specific areas or external clients.

Likewise and through virtual classrooms, different initiatives have launched to develop the digital capabilities of all these employees.

Talent management

In a changing environment, marked by dynamism and digital transformation, the attraction and retention of talent is one of the key issues for the profitability and sustainability of the business. At Telefonica, we firmly believe that our professionals are the most important asset of the Company and therefore, we work every day in the development of their capabilities, given we understand, that it is only achieving that maximum potential that we can fulfill the commitments established with our customers. We currently have a talent model that accompanies the employee in their career development, identifying the key skills and abilities that will help them to face our transformation process, aligned with the strategy and the company programme, "We choose it all".

With this model, we promote global talent programmes that contribute to the professional development of our teams, for the better implementation of the Company's strategy, in its different levels and segments, from young people to the managers.

In 2017, a select group of 86 young people of the company, from 11 countries, was part of the second edition of the Young Leaders Programme, focused on empowering the digital, transformational and leadership skills of young talent that meets the defined Digital Profile set by the Company. It is important to point out that, of the total number of participants, 53% were women. With this, we can say we are moving towards the retention of the Digital Generation and we are ensuring future leaders and collaborators with the characteristics of an environment in constant movement.

The development of programmes for key groups is essential to enhance gender and generational diversity, as well as inclusive leadership. Likewise, the identification of the talent map for the design of visibility actions is key in the evaluation and maximization of talent within the Company.

The Women in Leadership Programme has been set as part of the actions to strengthen the leadership of women within the Company. In Telefonica, initiatives such as this show that one of the priorities for action in our diversity plan is to guarantee equal opportunities for women and men in positions of responsibility. We believe that promoting diversity is a key component for talent management in all markets in which we are present.

Continuing with our commitment with the transformation, we have focused on actions that encourage continuous learning, securing at the same time the development of the digital profile. Within these initiatives, we find the implementation in SuccessFactors of the Learning Hub. A virtual space that brings together learning spaces from different sources, both internal and external, and where participants can access carefully selected information and promote microlearning (learning focused on short sessions). This space seeks to continue strengthening the culture of self-management in our employees.

Labor Relations

In virtue of the agreement reached with Union Network International (UNI), we are committed to the elementary standards of the ILO on work. This agreement, renewed at the end of 2014, remains in force and takes into account developments in matters of corporate responsibility as established in the Guiding Principles for Business and Human Rights of the United Nations, which clarify that companies must respect them in their chains of supply.

Respect for Human Rights is one of the foundations of our Responsible Business Principles. Our focus on HR has it grounds on five basic elements: people, technology, suppliers, the role in communities and, finally, the role in change through participation and alliance with strategic interest groups.

At Telefónica, we ensure the fundamental rights of the community included in the ILO conventions, which include aspects such as social dialogue, respect for the right of workers to be informed and consulted, and respect for trade union rights. We are also responsible for ensuring working conditions in the workplace and in the community by providing safe workplaces that safeguard the safety and health of our employees. As a Company, we ratify our support to deliver stable working conditions to our employees, promoting a harmonious working environment, in which tasks are fairly distributed.

Within our principles of responsible business, we collect the commitment we have with the workers, guaranteeing fair and adequate compensation to the labor framework in which we develop our operations. We ensure that our compensation policies and practices guarantee equal pay and opportunities for women and men.

At Telefónica, we also commit ourselves to comply with ILO conventions on freedom of association and trade union rights and to recognize the right of unions to represent and negotiate on behalf of workers, and without prejudice to existing local legislation.

As a company, we respect the rights of all workers to form and join the trade union of their choice and to bargain collectively, allowing the decision on whether or not to join a union is made by employees completely free from coercion.

Maintaining a neutral position regarding trade union activity is essential to ensure a free and open environment that allows the exercise of association rights. If the workers wish to unionize, Telefonica will recognize the unions that reunite the conditions of organization in accordance with ILO Convention 87, and always respecting local legislation. At the same time, Telefonica guarantees that workers' representatives will receive fair treatment, free of discrimination, and that they will have all the facilities to carry out their functions of representation.

Occupational Health and Safety

For Telefónica, it is a priority to declare its permanent commitment towards people, establishing a business management that protects the life, physical integrity and health of its workers.

According to the Principles of Responsible Business, the Company offers its employees a safe work environment. To this end, adequate mechanisms are established for the prevention of incidents that are associated with professional activity, through strict compliance with all regulatory regulations, the implementation of safe work procedures, training and the preventive management of safety and health. In work established throughout the organization.

The Occupational Prevention Risk Management System guarantees the integration of workers' safety and health in all Telefonica's processes and services through the development of a global model for the implementation of policies, procedures and common actions. Thanks to this system, Telefónica identifies and shares those practices that have shown a direct impact on the continuous improvement of the welfare of its employees, society in general and, consequently, the reduction of accidents.

Liquidity and capital resources

Financing

The main financing transactions carried out in the bond market in 2017 are as follows:

Item	Date	Maturity Date	Nominal (millions) Currency	Nominal (millions) Euros	Currency of issuance	Coupon
Telefónica Emisiones, S.A.U. [1]						
EMTN Bond	01/17/17	01/17/25	1,250	1,250	EUR	1.528%
EMTN Bond	01/17/17	10/17/28	500	500	EUR	2.318%
EMTN Bond	01/25/17	01/25/19	150	150	EUR	EURIBOR 3M + 0.40%
SHELF Bond	03/08/17	03/08/27	1,500	1,251	USD	4.103%
SHELF Bond	03/08/17	03/08/47	2,000	1,667	USD	5.213%
EMTN Bond (Retap)	03/17/17	10/17/28	200	200	EUR	2.318%
EMTN Bond	04/18/17	04/18/37	200	167	USD	4.900%
SHELF Bond (Retap)	04/28/17	03/08/47	500	417	USD	5.213%
EMTN Bond	09/12/17	01/12/28	1,250	1,250	EUR	1.715%

(1) Guaranteed by Telefónica, S.A.

During 2017 there was no outstanding amount under the main financing transactions arranged in 2017 in the bank market.

Available funds

At December 31, 2017, Telefónica S.A.'s available funds from undrawn lines of credit in different financial institutions totaled 9,967 million euros (of which 9,266 million euros maturing in more than 12 months). Additionally, cash and cash equivalents as of December 31, 2017 amount to 2,868 million euros.

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

Contractual commitments

Note 19 to the financial statements provides information on firm commitments giving rise to future cash outflows and associated with operating leases, primarily.

Credit risk management

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

Credit rating

At December 31, 2017, Telefónica, S.A.'s long-term issuer default rating is "BBB stable outlook" from Fitch, "Baa3 stable outlook" from Moody's and "BBB stable outlook" from Standard & Poor's. During 2017, there have not been changes in the credit ratings by any of the three agencies. Last changes in the credit ratings took place in 2016 when Moody´s downgraded the rating to "Baa3 stable" from "Baa2 negative" on November 7, 2016, Fitch downgraded the rating to “BBB stable” from “BBB+ stable” on September 5, 2016 and Standard and Poor’s revised the outlook to “stable” from “positive” on May 17, 2016.

European Commission's decision to block the proposed sale of O2 U.K. to Hutchison's Three U.K. in 2016 had an impact on Telefonica´s credit ratings and outlooks by Moody´s and Standard and Poor’s, as they considered that decision would delay the Company´s deleveraging process. In 2017, among the measures taken to protect the credit rating, it is noteworthy an intensive financing activity, taking advantage of historical low refinancing rates to extend average debt life, together with the maintenance of an appropriate level of liquidity, an active portfolio management through the completion of the 40% divestment of Telxius, and the issuance of undated deeply subordinated securities as a solvency protection measure to mitigate negative impacts on our on our financial statements.

Dividend policy

Telefónica, S.A.’s dividend policy is revised yearly based on the Group’s earnings, cash generation, solvency, liquidity, flexibility to make strategic investments, and shareholder and investor expectations. In 2016, the Annual General Meeting approved to pay a dividend, via scrip dividend of approximately 0.35 euros per share to be paid in November 2016.

On October 27, 2016, the Board of Directors of Telefónica, S.A. announced the dividend policy for the years 2016 and 2017. For the year 2016 the payment would be a total of 0.55 euros per share, adding to the scrip already approved by the Annual Shareholders Meeting, the payment of 0.20 euros in cash in the second quarter of 2017. Relating to 2017, it was announced that the dividend would amount to 0.40 euros per share: 0.20 euros in the fourth quarter of 2017 and 0.20 euros in the second quarter of 2018,both in cash.

On March 29, 2017 the Board of Directors of Telefónica, S.A. decided to define the corresponding payment periods of the dividends. Therefore, from there on, the dividend payment in the second quarter will take place in June, and the dividend payment in the fourth quarter will take place in December, in both cases on or before the third Friday of the corresponding month.

In this regard, the dividends paid during 2017 were paid on June 16 and December 14.

Treasury shares

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

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

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

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

At December 31, 2017 and 2016, Telefónica, S.A. held the following treasury shares:

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/31/17	65,687,859	10.48	8.13	534	1.26514%
Treasury shares at 12/31/16	141,229,134	10.48	8.82	1,246	2.80339%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A.during the years 2017 and 2016 is as follows:

	Number of shares
Treasury shares at 12/31/15	**141,639,159**
Acquisitions	77,087,297
Share plan delivery (see Note 19.3)	(2,869,334)
Share redemption	(74,627,988)
Treasury shares at 12/31/16	**141,229,134**
Share plan delivery (see Note 19.3)	(3,518,795)
Other movements	(72,022,480)
Treasury shares at 12/31/17	**65,687,859**

Acquisitions

There have been no acquisitions of treasury shares in 2017 (668 million euros in 2016).

Share redemption and disposals

In 2017 there has been no share redemption or disposals of treasury shares.

On October 13, 2016, pursuant to the resolution of the share capital reduction, by the cancellation of own shares, adopted by the Annual General Shareholders' Meeting of Telefónica held on May 12, 2016, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (Registro Mercantil). Therefore, 74,627,988 of the own shares of Telefónica, S.A. totaling 813 million euros were cancelled.

Employee share option plan

Treasury shares sold, including share plans redemptions, in 2017 and 2016 amount to 37 million euros and 26 million euros, respectively.

On July 31, 2017 the third phase of the Global Employee Share Plan ("the GESP") matured and 3,187,055 treasury shares were delivered to Group employees who met the established requirements.

On September 30, 2017 the first phase of the "Performance and Investment Plan 2014-2017" ("PIP 2014-2017") and the first phase of the "Talent for the Future Share Plan" (TFSP1) ended. No shares have been delivered to Telefónica Group executives or managers (see Note 19).

On June 30, 2016 the third phase of the Telefónica, S.A. long-term incentive plan called "Performance and Investment Plan 2013-2016" ("PIP 2013-2016") ended. No shares were delivered to Telefónica Group Management.

Other movements

On March 14, 2017 Telefónica entered into a swap agreement with Koninklijke KPN NV (hereinafter, KPN) to deliver 72 million of its treasury shares in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter. On the same date, this stake was sold at the same price to Telefónica Germany Holdings, GMBH so that, at 2017 year end, Telefónica, S.A. has no direct participation in Telefónica Deutschland Holding AG and the transfer of the stake has not had impact in the income statement.

The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 35.2 million of Telefónica shares in 2017 and 2016, recognized in both years under "Current interest-bearing debt" in the accompanying balance sheet.

Risk factors associated with the issuer

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 the Company which could affect its business, financial position, reputation, corporate image and brand and its results of operations, must be considered jointly with the information in the Annual Financial Statements, and are as follows:

Group-Related Risks

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

Telefónica's international presence enables the diversification of its activities across countries and regions, but it exposes Telefónica to 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 the Company'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.

Macroeconomic perspectives in Europe have improved as two major risks have diminished during 2017. First, political uncertainty has decreased after the results of the general elections in some European countries and, second, the agreement reached in relation to the Greek bailout program and better macroeconomic data in the country have opened the door to a potential solution to the Greek debt crisis in the near term. While such risks have diminished, economic activity and financial stability in Europe could be affected by the monetary normalization that the European Central Bank is expected to continue implementing in the near future, with a negative impact on the balance between the private and public sectors, and by the restructuring processes which the European banking sector is still immersed in. Furthermore, the planned exit of the United Kingdom from the European Union following the outcome of the referendum held in 2016, will 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. In the meantime, there is uncertainty regarding investment, economic activity, employment and financial market volatility. Finally, another possible source of uncertainty given Telefónica's exposure, could come from Catalonia's political situation and its impact on the Spanish economy. Although recent events point to a lower degree of uncertainty, if political tensions re-emerge or intensify, there could be a negative impact both on financing conditions and on the current positive Spanish macroeconomic scenario. In 2017, the Telefónica Group obtained 24.3% of its revenues in Spain (24.6% in 2016), 14.0% in Germany (14.4% in 2016) and 12.6% in the United Kingdom (13.2% in 2016).

In Latin America, there is an increasing exchange rate risk created by external factors such as the uncertainty derived from the monetary normalization process in the United States, the continuing low commodity prices in certain cases despite recent improvement, and doubts about growth and imbalances in China. Certain internal factors such as high fiscal and external deficits in major Latin American countries and the low liquidity in certain exchange markets, together with a low productivity growth, hinder a more accelerated progress in economic development and the rebalancing of still existent mismatches.

In Brazil, although the political scenario continues to be unstable, the government has approved relevant legislative reforms and promoted the approval of other key legislative items, such as the social security reform, which could be approved before the end of the term, which has improved the confidence levels in the government. While signs of stabilization have emerged and the economy has started to show positive growth figures, the pace of the recovery is still weak and the unemployment rate remains at 12%. Moreover, despite decreasing external financing needs, internal financing needs remain high. The combination of such elements has led to risks of further downgrades to the country's credit rating, which is already below investment grade, possibly leading to further currency depreciation.

Mexico has a high commercial and financial exposure to the United States, which could generate uncertainty despite having a relatively stable internal outlook, subject to the outcome of the coming general elections and of the renegotiation of the North American Free Trade Agreement (NAFTA), which is now underway. Any increase in interest rates in the United States and/or a possible renegotiation of trade agreements between both 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 2.6% for 2017.

In countries such as Chile, Colombia and Peru, increases in commodity prices are having a positive impact on their respective fiscal and external accounts, but growth continues to be affected by the lower external inflows, which have affected investment and, to a lesser extent, private consumption.

In Argentina, the government is focused on resolving the country's macroeconomic and financial imbalances and on recovering international confidence. The October legislative elections confirmed the good results of the government coalition. However, even though the economy has returned to positive growth rates and the measures taken by the government might continue having positive effects in the medium term, short term risks persist, including exchange rate risk, especially due to the high inflation rate.

In Ecuador, despite the recovery in oil prices and the recent U.S. dollar depreciation, which have allowed for an improvement in economic activity through exports, 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 more vulnerable position against volatility shocks.

During 2017 Telefónica Hispanoamérica represented 24.1% of the Telefónica Group's revenues (24.2% in 2016), of which 27.8% proceeded from revenues in Argentina, 18.5% in Peru and 17.4% in Chile. During 2017, Telefónica Brazil represented 23.1% of the Telefónica Group's revenues (21.3% in 2016). In this respect, 32.4% of the Group's revenues were generated in countries that do not have investment grade status (in order of importance, Brazil, Argentina, Venezuela, Ecuador, Guatemala, El Salvador, Nicaragua and Costa Rica), 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-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 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, 2017, 71.0% 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, 17.2% 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, 2017: (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 91 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 74 million euros, in each case for the year ended December 31, 2017. 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 17 million euros for the year ended December 31, 2017, primarily due to the weakening of the Venezuelan bolivar. These calculations have been made assuming a constant currency position with an impact on profit or loss as of December 31, 2017, taking into account derivative instruments in place.

During 2017, Telefónica Brazil represented 25.9% (24.5% in 2016), Telefónica Hispanoamérica represented 21.9% (23.0% in 2016) and Telefónica United Kingdom represented 10.1% (11.3% in 2016) 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.

In 2017, the evolution of exchange rates had a negative impact on results, decreasing the Group's consolidated revenues and OIBDA by an estimated 3.2 p.p. and 4.7 p.p., respectively, mainly due to the depreciation of the Argentine peso, the Venezuelan bolivar and the pound sterling. Furthermore, translation differences had a positive impact on the Group's equity of 2,049 million euros as of December 31, 2016 and a negative impact of 4,607 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 significant deterioration of conditions in the international or local financial markets due to monetary policies set by central banks, including increases in interest rates and/or balance sheet reductions, and oil price instability, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

As of December 31, 2017, the Group's net financial debt amounted to 44,230 million euros (48,595 million euros as of December 31, 2016) and, as of December 31, 2017, the Group's gross financial debt amounted to 55,746 million euros (60,361 million euros as of December 31, 2016). At such date, the average maturity of the debt was 8.08 years (6.35 years as of December 31, 2016).

As of December 31, 2017, the Group's gross financial debt scheduled to mature in 2018 amounted to 9,414 million euros, and gross financial debt scheduled to mature in 2019 amounted to 6,063 million euros.

In accordance with its liquidity policy, Telefónica has covered its gross debt maturities for the next twelve months with cash and credit lines available at December 31, 2017. As of December 31, 2017, the Telefónica Group had undrawn committed credit facilities arranged with banks for an amount of 13,531 million euros (12,541 million euros of which will expire in more than twelve months). Telefónica's liquidity could be affected if market conditions make it difficult to renew existing undrawn credit lines. As of December 31, 2017, 7.3% of the aggregate undrawn amount under credit lines was scheduled to expire prior to December 31, 2018.

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 standards IFRS 15 "Revenue from Contracts with Customers" and IFRS 9 "Financial instruments", effective from January 1, 2018, and IFRS 16 "Leases", effective from January 1, 2019.

These standards present significant changes that will affect the amount and timing of recognition of revenues and expenses related to certain sales transactions (IFRS 15), the estimation processes for the expected impairment losses on financial assets, the recognition period and the documentation of hedging policies and strategies (IFRS 9), as well as the accounting treatment for all lease contracts, other than certain short-term leases and leases of low-value assets (IFRS 16). The Group estimates that the first-time adoption of these changes will have a material impact on the Group's financial statements and may make comparisons between periods difficult and less meaningful.

Risks Relating to the Group’s Industry

The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.

The telecommunications sector is subject to laws and 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 risks of this nature are those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality. 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 provisions of services in a specific market. The spectrum to which each of the licenses and administrative concessions refers 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.

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 lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses.

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

On September 14, 2016, the European Commission (EC) adopted, among others, a proposed Directive for the establishment of a European Electronic Communication Code (EECC), which could have significant implications, *inter alia*, for access to networks, spectrum use, auction conditions, duration and renewal of licenses, universal service and consumer protection. The proposed Directive is currently going through the legislative process and its approval is expected in the second quarter of 2018.

On May 17, 2017, the European Parliament and Council approved a decision regarding the use and availability of the 700 MHz band. This could require new cash outflows from Telefónica between 2018 and 2022 in the United Kingdom and Spain. The 700 MHz band will initially allow the expansion of the capacity of 4G networks and, in the near future, the introduction of 5G services with new functionalities. In Spain, it is expected that the Ministry of Energy, Tourism and the Digital Agenda publishes its plan to release the 700 MHz band before June 30, 2018, in line with the calendar approved by the EC and with the 5G National Plan adopted in December 2017. The 5G National Plan also contemplates, among other matters, an urgent auction for the 3.6 GHz band at the beginning of 2018 and, possibly, also in the L band (1452- 1492 MHz).

In connection with the spectrum auction for the 2.3 and 3.4 GHz bands in the United Kingdom, on July 11, 2017 the Office of Communications (“**Ofcom**”) released rules for the upcoming mobile spectrum auction in both the 2.3 GHz (available for "immediate use") and 3.4 GHz bands (which may be used for 5G services). They set forth two separate spectrum caps: a spectrum cap of 255 MHz of immediately usable spectrum and an overall cap of 340 MHz. Hutchison 3G UK Ltd ("**H3G**") and BT filed a motion to review Ofcom's decision regarding the 3.4 GHz band based on the constraints imposed by the spectrum limits set forth in this band for which they can bid. The judgment was released in December 2017 and both appeals were dismissed. H3G tried to appeal the decision to the Court of Appeal and a hearing took place on February 13, 2018. The appeal was refused and the litigation ended. Therefore, the auction can now proceed without delay. Telefónica UK expects the bidding to start in March 2018.

In Germany, regarding its process to provide new frequencies for the further development of digital infrastructures, the regulatory agency for electricity, gas, telecommunications, post and railway ("**BNetzA**") published its position on the key elements on June 27, 2017 and, at the same time, initiated a procedure for determining the frequency demand for nationwide assignments in the 2 GHz and the 3.6 GHz bands (3.6 GHz is the official wording of BNetza when referring to 3.4-3.8 GHz). Among other things, for the 2 GHz band, BNetzA proposed the joint award of the frequencies expiring at the end of 2020 and 2025 and indicated that, following the merger of Telefónica Deutschland and E-Plus, it does not intend to withdraw any rights of use allocated to Telefónica Deutschland before their expiration (2020 and 2025, respectively). For the 3.6 GHz band, regional assignments for a part of the frequencies are provided for in the paper, as well as mutual co-usage rights between national and regional assignments. Additionally, it also foresees a demand-based supply with 5G. The procedures to auction both bands could begin in 2018 or 2019. The Telefónica Deutschland Group reported its request for frequency by the deadline of September 30, 2017 and commented on the key elements of the proposal. The final determination of the frequency demand and the first draft decisions in this regard are expected in the first quarter of 2018. For frequencies above 24 GHz, BNetzA intends to initially develop an application process in the 26 GHz frequency band.

In Latin America, 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 these licenses. Specifically, the procedures expected to take place in 2018 in jurisdictions that are relevant for the Group are:

- Mexico: An auction of spectrum in the 2500 MHz band is expected to take place in 2018.
- Colombia: In February 2017, the Ministry of Information Technologies and Communications ("ITC") published the conditions for the auction of 70 MHz of spectrum in the 700 MHz band and of 5 MHz of spectrum in the 1900 MHz band. The ITC modified through Decree 2194 of December 27, 2017 the spectrum caps, increasing them by 5MHz for high bands, reaching a total of 90 MHz, and by 15MHz for low bands, reaching a total of 45 MHz. On January 23, 2018, the ITC published a second project on the conditions of the 700 MHz auction, which included certain modifications, such as: the auction mechanism would be based on a multiple-round ascending clock auction, and the obligation to provide free wifi zones would be removed. This second project was subject to comments until February 20, 2018. The schedule for the auction has not yet been set but the ITC has announced that it should take place in 2018.
- Argentina: The government instructed the regulatory authority to issue new regulations during 2017 (i) to ensure the reassignment of frequencies of the radio spectrum for the provision of wireless or fixed wireless services (known as the "refarming process"), which Telefónica has challenged in court, and (ii) to enable the reassignment of frequencies previously granted to other providers (known as the "spectrum on demand process"). In connection with the latter, in May 2017 such "spectrum on demand process" was launched and, in June 2017, certain 2.6 GHz spectrum was granted to Telefónica and other licensed mobile operators, but the effective distribution of the spectrum is still pending.

It is possible that some of the above-mentioned spectrum tender procedures will not be completed, or even initiated within the proposed time frames. In addition to the above, it may be the case that certain administrations which have not yet announced their intention to release new spectrum, may do so during 2018 or 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 the United Kingdom, Telefónica has an obligation under the terms of its 800 MHz spectrum license to provide indoor coverage to 98% of the United Kingdom population (and 95% of the population of each of England, Wales, Scotland and Northern Ireland). It also has an obligation under the terms of its 900/1800 MHz spectrum license to provide voice and text services to 90% of the United Kingdom landmass. Both requirements had to be met by the end of 2017 and must be maintained thereafter. Telefónica United Kingdom continues to invest in its infrastructure improvement program, upgrading its 2G and 3G networks and working on the roll-out of its 4G network. Telefónica United Kingdom is in the process of providing information to the UK's regulatory authority, Ofcom, to demonstrate its compliance with the obligations mentioned above.

In Spain, also related to the licenses of the 800 MHz spectrum band, the assignee operators of 2x10MHz spectrum (Telefónica, Vodafone and Orange) must jointly complete before January 1, 2020 the offering of services provided with other technologies or in other bands of frequency, with the purpose of reaching coverage that allows access, with a speed of 30 megabits per second or faster, to at least 90% of the inhabitants in population units of less than 5,000 inhabitants. In this regard, there was a public consultation process open until January 22, 2018 regarding the way to implement this obligation. In any event, 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 obligations.

In Germany, in connection with the merger of Telefónica Deutschland Holding AG and E-Plus, three legal proceedings remain open before the European General Court against the decision of the EC authorizing such merger. Oral hearings were held in December 2017 and the decisions are expected in the first quarter of 2018.

In the state of São Paulo, Telefônica 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. In accordance with current regulations, Telefônica Brazil informed the Brazilian regulatory authority (*Agencia Nacional de Telecomunicações* or "**ANATEL**") that the net value of assets assigned to the provision of STFC was estimated to total 8,763 million Brazilian reals as of December 31, 2017 (approximately 2,209 million euros under the exchange rate applicable on such date). Under current regulations, Telefónica must update this information by April 30, 2018 by sending the updated list and value of the assets assigned to the provision of STFC as of December 31, 2017. In principle, such assets were considered to be reversible assets, and were thus supposed to be reverted to the Federal Government at the end of the concession agreement. A bill amending the regulatory framework in Brazil is in process, establishing, among other things, that such assets would no longer be reversible under a new license regime in exchange for significant broadband investment commitments. The bill has been approved at both legislative houses but has been challenged before the Federal Supreme Court due to an alleged procedural defect. The outcome of this lawsuit is uncertain, although the Senate's governing board may overcome it by sending the bill for voting in the Plenary (such action depends on the political environment, which is also uncertain). Such Court and, consequently, the Senate's governing board, has each decided to send 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.

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., ESP ("**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 radioelectric 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 28 November 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, were operating 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, after finding on August 4, 2017 that an arithmetic error required that the amount contained in the original award from July 25, 2017 be revised slightly downwards. 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*). In addition, on December 18, 2017, ColTel also filed a constitutional action "*acción de tutela*" seeking to protect its constitutional rights jeopardized by the arbitration award. On the other hand, pursuant to the relevant bilateral treaty, Telefónica notified Colombia of its intention to file a claim in the International Centre for Settlement of Investment Disputes ("**ICSID**") after the expiration of the 90-day notice period. After the expiration of such deadline, on February 1, 2018, Telefónica submitted the arbitration request to the ICSID.

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. In December 2014 and June 2016, Telefónica filed renewal requests for an additional twenty years in relation to a concession for the provision of local carrier services and to one of the concessions to provide mobile line services in certain provinces, respectively. 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.

Telefónica Móviles Chile, S.A. was awarded 2x10 MHz spectrum on the 700 MHz band in March 2014. While services are being provided on such spectrum, a consumer organization filed a claim against the allocation of spectrum on the 700 MHz band that is still pending.

During 2017, the Group's consolidated investment in spectrum acquisitions and renewals amounted to 538 million euros.

Regulation of wholesale services

The EC's proposal in respect of the regulatory framework intends, among other measures, to incorporate a methodology and a European upper limit for the call-termination prices for landline phones/mobile phones (FTRs/MTRs) applicable in the EU. The decreases in wholesale mobile termination rates ("**MTRs**") in Europe are noteworthy. 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, the current rate is 0.495 pence per minute. On June 27, 2017, Ofcom made a consultation on a proposal for a progressive reduction over a three-year period from April 1, 2018, which would result in a 10% reduction in real terms in MTRs during that period.

In Spain, in November 2017, the Spanish National Regulatory and Competition Authority (*Comisión Nacional de los Mercados y la Competencia* or "**CNMC**") submitted to the EC the draft measures to set the new MTRs for all the mobile operators, which would imply a progressive reduction of 40% from current levels. The proposed dates and MTRs would be as follows: since the decision becomes effective until December 31, 2018 at 0.0070 €/min; from January 1, 2019 until December 31, 2019 at 0.0066 €/min; and as from January 1, 2020 at 0.0064 €/min. A final decision was adopted in 2018 setting the rate at 0.0067 €/min during the year 2019.

In Latin America, the Group believes it is likely that MTRs will also be reduced in the short to medium term.

In Brazil, the *Plano Geral de Metas de Competição* ("**PGMC**"), amended by Resolution 649/2015, established that mobile termination fees are subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees are expected to be in force (such Resolution has been challenged in courts and the proceedings are ongoing). On December 5, 2016, ANATEL issued a public consultation for the revision of the PGMC, which addresses changes in the relevant wholesale markets regulated by the PGMC and also in the cost-oriented model. ANATEL is expected to deliberate on the new regulations during 2018.

In Mexico, on November 9, 2017, the *Instituto Federal de Telecomunicaciones* ("**IFT**") announced that the MTRs applicable to the so-called Prevailing Economic Agent ("**PEA**") for 2018 shall be 0. 028562 pesos per minute while the MTRs applicable to the operators other than the PEA shall be 0.112799. The IFT fixed the MTRs on the PEA's network as a result of a prior ruling of the Supreme Court of Justice in favor of the PEA and against its obligation to refrain from charging fees for the termination of mobile, fixed and SMS traffic on its network.

In Peru, the *Organismo Supervisor de las Telecomunicaciones* ("**OSIPTEL**") started in November 2016 the process to amend the maximum MTRs. On January 28, 2018, OSIPTEL published the caps on interconnection rates for MTRs. The approved rate is the same for all networks and entails a decrease of 63% (USD 0.00661 per minute rated at the second). The new fees established by OSIPTEL will apply as of the adoption of the regulation.

As a result of the foregoing regulatory actions, Telefónica may receive lower prices for certain of its services, which may materially adversely affect its business, financial condition, results of operations and/or cash flows. During the year ended December 31, 2017 the negative impact of these regulations is estimated to have resulted in the deduction of approximately 1 percentage point 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 the consumers in a country to a minimum set of services offered at reasonable and fair prices in order to avoid social exclusion. On its proposal for the reform of the regulatory framework issued on September 14, 2016, the EC sought to modernize USO in Europe, removing the mandatory inclusion of the legacy outdated services (telephone boxes, directories and information services) and focusing on the provision of affordable broadband services. The EC also proposed that USO should be funded out of general budgets and not from the sectoral budget. However, if this funding method does not thrive, the inclusion of affordable broadband services could end up being more expensive for the sector. In any case, the new regulation is not expected to be applicable before 2020.

In Spain, the USO for 2017 were extended for 2018, with Telefónica being responsible for the provision of the elements of Universal Service to fixed-broadband access, pay phones and directories.

In Brazil, a proposal of the General Plan for Universalization of Fixed Switched Telephony Services was approved by ANATEL in 2016. The final version, however, has not been published because the amendment to the underlying concession agreement has not been yet finalized.

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

On December 29, 2017, a draft measure on the economic replicability methodology to be used to assess the maximum wholesale access price which Telefónica could charge to other operators for accessing the optical fiber network in regulated areas (NEBA Local and NEBA services), was notified to the EC establishing a maximum wholesale access price of 16.38 €/month. The final decision is expected within the current first quarter of 2018. In June 2017, CNMC launched a public consultation on the methodology to analyze if Telefónica´s business offers can be replicated by other operators.

Any of such obligations and restrictions could raise costs and limit Telefónica's freedom to provide 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, will be directly applicable in all Member States from May 25, 2018. In addition, on January 10, 2017, the EC presented its proposal for a Regulation on privacy and electronic communications ("**ePrivacy**"), 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 2018.

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, has been challenged before the EU's General Court by civil-society groups, but the admission of their appeals is still pending as at the date of this Annual Report. Nevertheless, the EC completed on October 18, 2017 its first annual review on the performance of the Privacy Shield and concluded that the Privacy Shield continues to ensure an adequate level of data protection for personal data of European citizens.

In Brazil, the adoption of a Personal Data Protection Act is still pending. This act could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment.

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.

In Europe, network neutrality is regulated by Regulation (EU) 2015/2120 of November 25, 2015.

Telefónica operates in Latin American countries where net neutrality is being implemented, such as Chile, Colombia, Mexico, Peru (where OSIPTEL implemented regulations on net neutrality on January 1, 2017) and in Brazil. In Mexico, it is expected that IFT will issue guidelines during 2018. In Chile, on November 22, 2016, the Commission of Telecommunications submitted a bill for amending the Network Neutrality Act. The main changes proposed concern the establishment of rules applying measures for traffic management and restrictive rules for "Zero Rating".

If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and/or cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to various anti-corruption laws, including the 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 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 conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with and cooperating with governmental authorities about these matters and intends to continue to cooperate with those authorities as the investigations continue. It is not possible at this time to predict the scope or duration of these matters or their likely outcome.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects Telefónica's competitive position relative to other technology sector companies, and its ability to extract the value generated during the process of digital transformation we are immersed in. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and/or cash flows.

Telefónica may not be able to adequately foresee and respond to technological changes and sector trends.

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances. The entry of new competitors in the markets where the Group is the leader, such as Chile and Peru, has resulted in the Group losing market share in the mobile phone market during the period between 2014 and the end of 2017. In this competitive environment, the Group has focused on its high-value customers and estimates that the loss of revenues has been lower than the loss of accesses.

Failure to adequately anticipate and adapt to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances could have an adverse effect on the Group's business, financial condition, results of operations and/or cash flows.

New products and technologies arise constantly and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 862 million euros in 2017, representing a decrease of 4.8% from 906 million euros in 2016 (1,055 million euros in 2015). These expenses represented 1.7%, 1.7% and 1.9% of the Group's consolidated revenues in 2017, 2016 and 2015, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development ("**OECD**") manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 300MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. In Spain, as of December 2017 Telefónica has already 19.2 million premises passed with fibre (representing 66% of the households), which shows the level of investment required. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of income and additional efficiencies to those traditionally sought. Failure to do so adequately could have an adverse effect on the Group's business, financial condition, results of operations and/or cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond to Telefónica's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency. Any failure by Telefónica Group's IT systems to adequately respond to the Group's evolving operating requirements could have an adverse effect on the Group's business, financial condition and/or results of operations.

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 inappropriate practices are produced by a participant in the supply chain.

As of 31 December 2017, the Telefónica Group depended on three handset suppliers and 10 network infrastructure suppliers, which, together, accounted for 79% and 78%, respectively, for the awarded contracts as of such date (for their products groups). One of the handset suppliers represented two-fifths of all handset allocations 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.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse effect on 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.

Unanticipated network interruptions as a result of system failures, including those due to natural disasters caused by natural or meteorological events (due, in turn, to extreme weather conditions, especially in the geographies with greater exposure to them), network, hardware or software failures, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses have become increasingly dependent on telecommunications and computer networks and adopt 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 on employees with access. Further, our employees or other persons may have unauthorized or authorized access to our systems and/or take actions that affect our 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. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization, that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to Telefónica being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may adversely affect the business, financial conditions, results of operations and/or cash flows of the Telefónica Group.

Possible regulatory, business, economic or political changes could lead to asset impairment.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize 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. No impairments were recognized in 2017. In 2016, impairment losses in goodwill were recognized amounting to an aggregate amount of 215 million euros, relating to Telefónica ´s operations in Venezuela (124 million euros) and in Mexico (91 million euros).

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

Any of the foregoing could have an adverse 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, tax claims, antitrust 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 17 and 20 to the Annual Financial Statements.

Trend evolution

In 2017, Telefónica made progress towards long-term sustainable and profitable growth in service revenues, continuing to increase efficiencies and capturing synergies thanks to the integrated vision of the businesses, processes and technologies. This allowed us to maintain a strong investment effort in order to be able to offer our customers excellent connectivity. In recent years, the Company has moved forward in its business transformation:

- Firstly, Telefónica preserves a business model with data-oriented offers, bundled services, including converged fixed and mobile services, as well as digital capabilities as part of the global transformation focused on responding to the change in our customers' consumer habits. An essential part of our effort has been the investment in fiber and LTE networks, which we believe will allow the monetization of data as well as of digital services. In this way, Telefónica has significantly increased data accesses, including 68 million smartphones accesses, 3.3 million Pay TV accesses and 9.2 million fiber accesses during the 2015-2017 period. Additionally, average revenue per access increased by 4.1% year-on-year over the 2016-2017 period, from a year-on-year increase of 2.8% over the 2015-2016 period.

- Secondly, changing consumer habits have resulted in a decreasing demand for voice services and an increasing demand for data, due to video downloads and internet connectivity through smartphones. This new trend has allowed us since 2015 to compensate the drop in voice revenues (excluding falls in interconnection tariffs) with higher data and service over connectivity, resulting in a positive trend in average revenue per access in the majority of our markets.

- Thirdly, Telefónica launched in 2014 a simplification program focused on increasing growth and capturing synergies across the board; commercial offer simplification; IT network and global process modernization (through higher investments in IT and commercial systems as well as call centre costs reduction); and improving sales channels with a more efficient back office. All these measures allow resource liberation, resources that can be used for improving network. In 2014 we began to prepare our digitalization, designing in 2017 a program that includes from the systems that will facilitate that digitalization, the processes we have to adapt to achieve our digitalization targets that allow us to improve the service for our customers and achieve savings.

On the other hand, various factors have contributed to the fact that Telefónica has experienced a downward trend in some key financial performance indicators during the 2015-2017 period.

- First, changes in foreign exchange rates, particularly in 2015 with the depreciation of the Brazilian real against the euro and the effects of the depreciation of the Venezuelan bolivar. In 2016 such currencies continued to depreciate and the Company's results were also affected by devaluations in the United Kingdom, Argentina and Mexico, adversely and significantly affecting revenue growth.

- Second, the high inflation in certain countries affected cost growth in numerous markets where Telefónica is present which were not completely offset by the increase in tariffs.

- Third, Telefónica's business is highly regulated, which affects its revenues and imposes costs on its operations. For example, the regulators have progressively reduced in recent years the fixed rates that Telefónica charges for calls received from other companies' networks; the new roaming-out regulation ("Roam Like At Home" - RLAH); and the arbitration award of 470 million euros affecting Telefónica Colombia in relation to the reversion of certain assets used for the provision of services under old concession agreements.

- Fourth, in recent years Telefónica has experienced an intense competition in the markets where it operates, resulting in more bundled offers and making it difficult to monetize value added services.

- Fifth, in the last three years, within the above mentioned simplification process, Telefónica has redefined its processes, readapting its resource necessities, resulting in various provisions which have affected, results in 2016 as well as in 2017.

The positive result of the strategy with focus on sustainable and profitable growth is reflected in an upward trend in key market indicators as the operating cash flow (OIBDA-Capex) and net income. The operating cash flow continues its growth and was up 123.6% year-on-year over the 2016-2015 period and 21.0% over the 2017-2016 period. These better results were also seen in the net income, which increased by 16% over the 2017-2016 period.

Events after the reporting period

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

Financing

- On January 22, 2018, Telefónica, S.A. drew down 100 million euros of its bilateral loan signed on December 28, 2017 and maturing in 2020.
- On January 22, 2018, Telefónica Emisiones, S.A.U. launched under its EMTN Programme, updated on June 29, 2017, an issuance of notes amounting to 1,000 million euros. These notes are due on January 22, 2027, pay an annual coupon of 1.447% and are guaranteed by Telefónica, S.A.
- On January 23, 2018, Telefónica, S.A. drew down 385 million euros of its bilateral loan signed on December 20, 2017 and maturing in 2019.
- On January 30, 2018, Telefónica, S.A. drew down 100 million euros of its bilateral loan signed on November 24, 2017 and maturing in 2026.
- On February 2, 2018, Telefónica Emisiones, S.A.U. redeemed 750 million sterling pounds of its notes issued on February 2, 2006. The notes were guaranteed by Telefónica, S.A.

Investments

- In order to provide the funds needed to rebalance its equity and to execute share capital increases in its direct affiliates, Telefónica Digital España, S.L.U. on January 11, 2018 carried out a capital increase amounting to 194 million euros, totally subscribed and disboursed by Telefónica, S.A.

New organizational structure

The Board of Directors of Telefónica, S.A., at its meeting held on January 31, 2018, resolved to adopt a new organizational structure in order to make the Company more agile, simple and focused on management, customer service, growth, efficiency and profitability.

The main changes are detailed below:

- the areas of General Counsel, and Public Affairs and Regulation, up until now led by Mr. Ramiro Sánchez de Lerín and Mr. Carlos López Blanco respectively, is unified and headed by Mr. Pablo de Carvajal.
- Mr. Emilio Gayo will replace Mr. Luis Miguel Gilpérez as Executive Chairman of Telefónica España and member of the Executive Committee of Telefónica, S.A.
- Telefónica Hispanoamérica, until now headed by Mr. Eduardo Caride (also a member of the Executive Committee), is split into two new units in order to more effectively manage the different market situations: Telefónica Hispam Sur unit is created (encompassing operations in Argentina, Chile, Peru and Uruguay), which is led by Mr. Bernardo Quinn (until now Director of Global Human Resources), and Telefónica Hispam Norte unit is created (encompassing the operations in Colombia, México, Central America, Ecuador and Venezuela), which is led by Mr. Alfonso Gómez Palacio.

the area of People (Human Resources) is enhanced and will report directly to the Executive Chairman. This area will be led by Ms. Marta Machicot, who will join the Executive Committee.

Annual Corporate Governance Report for Listed Companies

A. Ownership structure

A.1 Complete the following table on the company's share capital:

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

Indicate whether different types of shares exist with different associated rights:

No

A.2 List the direct and indirect holders of significant ownership interests in your company at year-end, excluding directors:

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	268,230,302	0	5.17%
CaixaBank, S.A.	259,611,788	342,072	5.01%
BlackRock, Inc.	0	344,259,683	6.63%

Name or corporate name of indirect holder	Through: Name or corporate name of direct holder	Number of voting rights
CaixaBank, S.A.	VidaCaixa, S.A. de Seguros y Reaseguros	342,072
BlackRock, Inc.	BlackRock Group	344,259,683

Indicate the most significant movements in the shareholding structure during the year.

Name or corporate name of shareholder	Date of transaction	Description of transaction
--	--	--

A.3 Complete the following tables on company directors holding voting rights through company shares.

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	% of total voting rights
Mr. José María Álvarez-Pallete López	1,351,958	0	0.03%
Mr. Isidro Fainé Casas	595,382	0	0.01%
Mr. José María Abril Pérez	157,077	158,211	0.01%
Mr. Ángel Vilá Boix	333,463	0	0.01%
Ms. Eva Castillo Sanz	113,594	0	0.00%
Mr. José Javier Echenique Landiríbar	31,850	75,712	0.00%
Mr. Peter Erskine	42,733	0	0.00%
Mr. Luiz Fernando Furlán	38,423	0	0.00%
Ms. Carmen García de Andrés	704	0	0.00%
Mr. Ignacio Moreno Martínez	18,311	0	0.00%
Mr. Francisco Javier de Paz Mancho	64,862	0	0.00%
Mr. Francisco José Riberas Mera	0	49,173	0.00%

Name or corporate name of indirect shareholder	Through: Name or corporate name of direct shareholder	Number of voting rights
Mr. José María Abril Pérez	Other company shareholders	158,211
Mr. José Javier Echenique Landiríbar	Other company shareholders	75,712
Mr. Francisco José Riberas Mera	Other company shareholders	49,173

% of total voting rights held by the Board of Directors
0.06%

Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights	Equivalent number of shares	% of total voting rights
Mr. José María Álvarez-Pallete López	192,000	0	300,000	0.00%
Mr. Ángel Vilá Boix	120,000	0	187,500	0.00%

A.4 Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are of little relevance or arise from ordinary trading or exchange activities.

A.5 Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are of little relevance or arise from ordinary trading or exchange activities.

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Banco Bilbao Vizcaya Argentaria, S.A. (or any of the companies of its Group), together with Telefónica, S.A. and with Caixabank, S.A., in Telefónica Factoring España, S.A., 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.
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.A.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 Mexico, S.A. de C.V. (subsidiary of Telefónica, S.A.) in Adquira de México, S.A. de C.V.
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 Indicate whether any shareholders' agreements have been notified to the company pursuant to Articles 530 and 531 of the Spanish Corporations Act (Ley de Sociedades de Capital, hereinafter "LSC" in Spanish). Provide a brief description and list the shareholders bound by the agreement, as applicable.

Yes

Parties to the shareholders' agreement
Vivendi, S.A.
Telefónica, S.A.

% of share capital affected
0.95%

Brief description of the agreement:

See heading H “Other information of interest”, Note 5 to Section A.6.

Parties to the shareholders’ agreement
Telefónica, S.A.
China Unicom (Hong Kong) Limited

% of share capital affected
1.24%

Brief description of the agreement:

See heading H “Other information of interest”, Note 5 to Section A.6.

Parties to the shareholders’ agreement
Telefónica, S.A.
Koninklijke KPN NV

% of share capital affected
1.43%

Brief description of the agreement:

See heading H “Other information of interest”, Note 5 to Section A.6.

Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable.

No

Expressly indicate any amendments to or termination of such agreements or concerted actions during the year.

See heading H “Other information of interest”, Note 5 to Section A.6.

A.7 Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with Article 5 of the Spanish Securities’ Market Act (Ley del Mercado de Valores). If so, identify.

No

A.8 Complete the following tables on the company’s treasury shares.

At year end:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
65,687,859	0	1.27%

(*) Through:

-

Detail any significant changes during the year, in accordance with Royal Decree 1362/2007.

Explain any significant changes

On September 26, 2017 all of the treasury stock movements made by the Company from the last notification were communicated to the Spanish National Securities Market Commission (effective December 9, 2016) in order to modify the number of voting rights of Telefónica, S.A. This was derived from an increase in capital with the issue of 154,326,696 new shares in response to the expiration of some convertible bonds (whose issuance was disclosed to the market via press releases of Significant Event on September 10 and 11, 2014, with register number 210598 and 210620, respectively). Among the treasury stock movements communicated, the most relevant corresponds to the transmission, of 72,007,507 Company shares, dated March 14, 2017, which represented 1.387% of the share capital, as a consequence of the share swap carried out with Koninklijke KPN NV (KPN) that was notified to the Spanish National Securities Market Commission through Significant Event on March 13, 2017,with register number 249449.

The transmissions on August 2 and September 21, 2017 correspond to the conversion of the previously mentioned Bonds. For these purposes, the minimum value of the share was set at 9.7174 euros.

The rest of the transmissions correspond to the execution of different incentive plans for employees. Considering all the transactions made by the Company from December 9, 2016 to September 26, 2017, a total of 75,359,265 shares were directly transmitted, which represented 1.451% of the share capital.

A.9 Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting authorizing the Board of Directors to repurchase or transfer the treasury shares.

At Telefónica's Ordinary General Shareholders Meeting held on May 30, 2014, the shareholders resolved to renew the authorisation granted at the General Shareholders Meeting of June 2, 2010, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

"A) Authorise, pursuant to articles 144 and the articles thereunder of the Spanish Corporations Act, the derivative acquisition, at any point and as many times as it might be deemed necessary, by Telefónica, S.A. – either directly, or through any of its subsidiaries – of treasury stock, fully-paid, by purchase and sale, by exchange or by any other legal transaction.

The minimum acquisition price or minimum value of the consideration shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or maximum consideration value shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders' Meeting and is expressly subject to the limitation that the par value of the Company's own shares acquired directly or indirectly pursuant to this authorization added to those already held by Telefónica, S.A. and all its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company's own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights owned by them, all within the framework of duly approved compensation systems referencing the listing price of the Company's shares.

B) To authorize the Board of Directors, as broadly as possible, to exercise the 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 III on the Agenda by the Ordinary General Shareholders Meeting of the Company on June 2, 2010."

A.9.bis. Estimated free-float capital:

Estimated free-float capital	%
	80.94

A.10 Indicate, as applicable, any restrictions on the transfer of securities and/or any restrictions on voting rights. In particular, indicate any type of restrictions that could impose obstacles to the takeover of the company by means of share purchases on the market.

Yes

Description of the restrictions
See heading H "Other information of interest", Note 7 to Section A.10.

A.11 Indicate whether the General Shareholders' Meeting has agreed to take neutralisation measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.

No

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted.

--

A.12 Indicate whether the company has issued securities not traded in a regulated market of the European Union.

Yes

If so, identify the various classes of shares and, for each class of shares, the rights and obligations they confer.

Shares of Telefónica, S.A. are traded on the Spanish electronic trading system (the "Continuous Markets"), and also on the stock exchanges of New York, London, Lima and Buenos Aires, and they all have the same characteristics, rights and obligations.

On the New York and Lima stock exchanges, Telefónica, S.A. shares are traded through American Depositary Shares (ADSs), where each ADS represents a Company share.

B. General Shareholders Meeting

B.1 Indicate and, as applicable, describe any difference between the system of minimum quorums for constitution of the General Shareholders Meeting established in the Spanish Corporations Act (Ley de Sociedades de Capital, hereinafter "LSC" in Spanish).

No

B.2 Indicate and, as applicable, describe any differences between the company's system of adopting corporate resolutions and the framework established in the LSC:

No

Describe how they differ from the rules established in the LSC.

--

B.3 Indicate the rules governing amendments to the company's Bylaws. In particular, indicate the majorities required to amend the Bylaws and, if applicable, the rules for protecting shareholders' rights when changing the Bylaws.

The Bylaws and Regulations for the General Shareholders Meeting of Telefónica confer upon the General Shareholders Meeting the power to agree to amend the Corporate By-laws (articles 15 and 5, respectively), being subject to legal provisions applicable for all other matters.

The procedure for amending the Bylaws is governed by Articles 285 and following articles of the revised text of the Spanish Corporations Act, and needs to be approved at the General Shareholders Meeting with the majorities stated in Articles 194 and 201 of the same law. In particular, if the Shareholders Meeting is convened to deliberate on Bylaw amendments, including capital increases or decreases, on eliminating or restricting the preferential acquisition right for new shares, and the transformation, merger, spin-off, or the global assignment of assets and liabilities and the relocation of the registered offices abroad, then shareholders which own at least fifty per cent of the subscribed capital with voting rights will have to be present or be represented by proxy on first call. If there is no sufficient quorum, then the Shareholders' Meeting will be held on second call, on this occasion at least twenty-five per cent of the subscribed capital with voting rights will need to be present, either in person or by proxy. When shareholders which represent less than fifty per cent of the subscribed capital with voting rights are present at the Shareholders Meeting, either in person or by proxy, the resolutions referred to above can only be approved when two thirds of the capital, present or represented by proxy at the Shareholders Meeting, vote in favour of the resolution.

Pursuant to article 286 of the Spanish Corporations Act, if the Bylaws are amended, then the Directors, or, if applicable, the shareholders who have made the proposal, will have to draw up in full the text of their proposed amendment, and a written report in which they justify the amendment, which will have to be submitted to the shareholders which are taking part in the Shareholders' Meeting to deliberate on that amendment.

Furthermore, pursuant to article 287 of the Spanish Corporations Act, the announcement calling the General Shareholders Meeting will have to clearly state the questions which might have to be amended, and note that all the shareholders are entitled to analyse the full text of the proposed amendment and the report on such an amendment at the registered offices, and also to request that such documents be delivered to them or sent free of charge.

According to article 291 of the Spanish Corporations Act, when new obligations are established for shareholders due to amendment of the Bylaws, the resolution will have to be passed with the approval of the affected shareholders. Furthermore, if the amendment directly or indirectly affects a type of shares, or part of them, then the provisions of article 293 of that Act will be applicable.

The procedure for voting on proposed resolutions by the Shareholders' Meeting is also regulated in Article 197 bis of the Spanish Corporations Act, in the internal regulations of Telefónica (in particular, in Article 23 of the Regulations of the General Shareholders Meeting). This Article states that, when amendments are made to the Bylaws, each article or group of articles which are materially different will be voted for separately.

B.4 Indicate the attendance figures for the General Shareholders' Meetings held during the year:

	Attendance data				
			% remote voting		
Date of general meeting	% attending in person	% by proxy	Electronic means	Other	Total
2016/05/12	0.21%	55.34%	0.03%	0.55%	56.13%
2017/06/09	0.27%	55.71%	0.03%	0.49%	56.50%

B.5 Indicate whether the Bylaws impose any minimum requirement on the number of shares required to attend the General Shareholders Meetings.

Yes

Number of shares required to attend the General Shareholders Meetings
300

B.6 Section eliminated.

B.7 Indicate the address and mode of accessing corporate governance content on your company's website as well as other information on General Meetings which must be made available to shareholders on the website.

Telefónica complies with applicable legislation and best practices in terms of the content of its website concerning Corporate Governance. In this respect, it fulfils both the technical requirements for access and for content for the Company website, including information on General Shareholders Meetings, through direct access from the homepage of Telefónica, S.A. (www.telefonica.com) in the section "Shareholders and Investors" (www.telefonica.com/accionistaseinversores), which includes not only all of the information that is legally required, but also information that the Company considers to be of interest.

All the available information included on the Company website, except for certain specific documents, is available in two languages: Spanish and English.

C. Company management structure

C.1 Board of Directors

C.1.1 List the maximum and minimum number of directors included in the Bylaws:

Maximum number of directors	20
Minimum number of directors	5

C.1.2 Complete the following table with board members' details.

Name or corporate name of director	Represen-tative	Type of director	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. José María Álvarez-Pallete López	-	Executive	Chairman	2006/07/26	2017/06/09	Resolution of General Shareholders' Meeting
Mr. Isidro Fainé Casas	-	Proprietary	Vice Chairman	1994/01/26	2016/05/12	Resolution of General Shareholders' Meeting
Mr. José María Abril Pérez	-	Proprietary	Vice Chairman	2007/07/25	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Ángel Vilá Boix	-	Executive	Chief Operating Officer (C.O.O.)	2017/07/26	2017/07/26	Co-opting
Ms. Eva Castillo Sanz	-	Other external Directors	Director	2008/01/23	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Juan Ignacio Cirac Sasturain	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. José Javier Echenique Landiríbar	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. Peter Erskine	-	Independent	Director	2006/01/25	2016/05/12	Resolution of General Shareholders' Meeting
Ms. Sabina Fluxà Thienemann	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. Luiz Fernando Furlán	-	Independent	Director	2008/01/23	2013/05/31	Resolution of General Shareholders' Meeting
Ms. Carmen García de Andrés	-	Independent	Director	2017/05/04	2017/06/09	Resolution of General Shareholders' Meeting
Mr. Peter Löscher	-	Independent	Director	2016/04/08	2016/05/12	Resolution of General Shareholders' Meeting
Mr. Ignacio Moreno Martínez	-	Proprietary	Director	2011/12/14	2017/06/09	Resolution of General Shareholders' Meeting
Mr. Francisco Javier de Paz Mancho	-	Independent	Director	2007/12/19	2013/05/31	Resolution of General Shareholders' Meeting
Mr. Francisco José Riberas Mera	-	Independent	Director	2017/05/04	2017/06/09	Resolution of General Shareholders' Meeting
Mr. Wang Xiaochu	-	Proprietary	Director	2015/09/30	2016/05/12	Resolution of General Shareholders' Meeting

Total number of directors
16

Indicate any board members who left during this period.

Name or corporate name of director	Type of directorship at time of leaving	Leaving date
Mr. César Alierta Izuel	Other external Director	2017/05/04
Mr. Gonzalo Hinojosa Fernández de Angulo	Independent	2017/05/04
Mr. Pablo Isla Álvarez de Tejera	Independent	2017/05/04
Mr. Julio Linares López	Other external Director	2017/07/26
Mr. Antonio Massanell Lavilla	Proprietary	2017/12/21

C.1.3 Complete the following tables on board members and their respective categories:

EXECUTIVE DIRECTORS

Name or corporate name of director	Post held in the company
Mr. José María Álvarez-Pallete López	Executive Chairman
Mr. Ángel Vilá Boix	Chief Operating Officer (C.O.O.)

Total number of executive directors	2
% of the Board	12.50%

EXTERNAL PROPRIETARY DIRECTORS

Name or corporate name of director	Name or corporate name of significant shareholder represented or proposing appointment
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Isidro Fainé Casas	CaixaBank, S.A.
Mr. Wang Xiaochu	China Unicom (Hong Kong) Limited

Total number of proprietary directors	4
% of the Board	25.00%

INDEPENDENT EXTERNAL DIRECTORS

Name or corporate name of director	Profile
Mr. Juan Ignacio Cirac Sasturain	Graduated in Theoretical Physics. Ph. D. in Physics. Fields of Specialization in Quantum Optics, Quantum Computation, Atomic Physics.
Mr. José Javier Echenique Landiríbar	Economic and Actuarial Sciences Graduate. Vice-Chairman of Banco Sabadell, S.A.
Mr. Peter Erskine	Psychology Graduate. Was General manager of Telefónica Europe until December 2007. Was Chairman of Ladbrokes, Plc until December 2015.
Ms. Sabina Fluxà Thienemann	Business Management and Administration graduate. MBA from ESADE. High Business Management Program at IESE. Co-Vice Executive President and CEO of Iberostar Group.
Mr. Luiz Fernando Furlán	Degrees in chemical engineering and business administration, specialising in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.
Ms. Carmen García de Andrés	Degree in Economic and Business Sciences. Chairwoman of Tomillo Foundation.
Mr. Peter Löscher	Degree in Economics and Business. MBA at Vienna University of Economics. Advanced Management Program at Harvard Business School. Chairman of the Supervisory 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
% of the Board	56.25%

List any independent directors who receive from the company or group any amount or payment other than standard director remuneration or who maintain or have maintained during the period in question a business relationship with the company or any group company, either in their own name or as a significant shareholder, director or senior manager of an entity which maintains or has maintained the said relationship.

No

If applicable, include a statement from the board detailing the reasons why the said director may carry on their duties as an independent director.

OTHER EXTERNAL DIRECTORS

Identify the other external directors and list the reasons why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders.

Name or corporate name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained
Ms. Eva Castillo Sanz	On February 26, 2014, Ms. Eva Castillo Sanz resigned as Chairwoman of Telefónica Europa, and was therefore included in the "Other external Directors" category.	Telefónica, S.A.

Total number of other external directors	1
% of the Board	6.25%

List any changes in the category of each director which have occurred during the year.

Name or corporate name of director	Date of change	Former category	Current category
-	-	-	-

C.1.4 Complete the following table on the number of female directors over the past four years and their category.

	Number of female directors				% of total directors of each type			
	Year 2017	Year 2016	Year 2015	Year 2014	Year 2017	Year 2016	Year 2015	Year 2014
Executive	0	0	0	0	0.00%	0.00%	0.00%	0.00%
Proprietary	0	0	0	0	0.00%	0.00%	0.00%	0.00%
Independent	2	1	0	0	22.22%	11.11%	0.00%	0.00%
Other External	1	1	1	1	100.00%	33.33%	33.33%	50.00%
Total:	3	2	1	1	18.75%	11.11%	5.56%	5.56%

C.1.5 Explain the measures, if applicable, which have been adopted to ensure that there is a sufficient number of female directors on the board to guarantee an even balance between men and women.

Explanation of measures

See heading H "Other information of interest". Note 9 to Section C.1.5.

C.1.6 Explain the measures taken, if applicable, by the Nominating Committee to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors, and whether the company makes a conscious effort to search for female candidates who have the required profile.

Explanation of measures

In accordance with Article 10.3 of the Board Regulations, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized calibre, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

In this context, 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.

When, despite the measures taken, there are few or no female directors, explain the reasons.

Explanation of the 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, it observes the qualitative leap that the Company has made in this area, having gone from 5.56% in 2015, to 11.11% in 2016 and, finally, to 18.75% in 2017.

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.

In both proposals to appoint (Ms. Sabina Fluxà Thienemann and Ms. Carmen García de Andrés), the Nominating, Compensation and Corporate Governance Committee considered the solvency, competency, experience, professional merits and availability of Ms. Fluxà and Ms. García de Andrés for their effective performance of the duties, exclusively considering their individual and professional characteristics. All of this was included in the framework of the then valid 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.1.6.bis Explain the conclusions of the Nominating Committee regarding verification of compliance with Director selection policy. And, in particular, how this policy is being used towards the target that at least 30% of the total members of the Board of Directors should be female directors by 2020.

Explanation of conclusions.

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 favours the diversity of knowledge, experience, and gender without incurring in any implicit bias that may imply any discrimination whatsoever.

Said 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).

Within the framework of the Selection of Board Members Policy (valid before the approval, on December 13, 2017 of the Policy of Diversity in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members), during the 2017 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 favour the diversity of knowledge, experience, and gender, without incurring in any implicit bias that may imply any discrimination whatsoever.

Thus, in its meeting celebrated on May 3, 2017 the Committee proposed to the Company's Board of Directors the appointment by co-option as Independent Board Members Ms. Carmen García de Andrés and Mr. Francisco José Riberas Mera, after the voluntary resignation from their positions as Board Members presented by Mr. César Alierta Izuel, Mr. Gonzalo Hinojosa Fernández de Angulo, and Mr. Pablo Isla Álvarez de Tejera. And, similarly, in its meeting celebrated on July 25, 2017 the Committee favourably informed the appointment by co-option of Mr. Ángel Vilá Boix as Executive Board Member in replacement of Mr. Julio Linares López.

Likewise, within the framework of the Selection of Board Members Policy (valid before the approval, on December 13, 2017 of the Policy of Diversity in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members), the Committee favourably 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 Meeting of Shareholders celebrated on June 9, 2017 approved, at the proposal of the Company's Board of Directors, the re-election of Mr. José María Álvarez-Pallete López and of Mr. Ignacio Moreno Martínez, as well as the ratification of the appointments of Ms. Carmen García de Andrés and Mr. Francisco José Riberas Mera.

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 (valid before the approval, on December 13, 2017 of the Policy of Diversity 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 presented to the General Meeting of Shareholders celebrated on June 9, 2017.

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 11.11% in 2016, and finally to 18.75% in 2017.

C.1.7 Explain how shareholders with significant holdings are represented on the board.

As stated in section C.1.3 of this Annual Corporate Governance Report, at December 31, 2017, the group of external Directors of Telefónica, S.A. was composed of 14 members (out of a total of 16 Members), of whom 4 are proprietary Directors, 9 are independent and 1 falls under the "Other external Directors" category.

Of the four proprietary Directors, at December 31, 2017, one acts in representation of CaixaBank, S.A. which holds 5.01% of the capital stock of Telefónica, S.A., and two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 5.17% of the capital; and one in representation of China Unicom (Hong Kong) Limited (China Unicom), which owns 1.24% of the capital stock. The percentages mentioned above refer to December 31, 2017.

It is noted that until December 21, 2017, there were two Directors who acts in representation of CaixaBank, S.A.

C.1.8 Explain, when applicable, the reasons why proprietary directors have been appointed upon the request of shareholders who hold less than 3% of the share capital:

Name or corporate name of shareholder	Reasons
China Unicom (Hong Kong) Limited	As explained in Section H "Other information of interest", Note 5 to Section A.6 of this report, on January 23, 2011, expanding on their existing strategic alliance, Telefónica, S.A. and China Unicom (Hong Kong) Limited (“China Unicom”) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their Strategic 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 now member of the Board of Directors of Telefónica, S.A.

Provide details of any rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors. If so, explain why these requests have not been entertained.

No

C.1.9 Indicate whether any director has resigned from office before their term of office has expired, whether that Director has given the board his/her reasons and through which channel. If made in writing to the whole board, list below the reasons given by that director.

Name of director	Reasons for resignation
Mr. César Alierta Izuel	The Director Mr. César Alierta Izuel, in order to refresh the Board of Directors of the Company, formally stated his voluntary resignation to the Board of Directors, at its meeting held on May 4, 2017, effective as of that date, from its position as Director of Telefónica, S.A., and thus from all of his position within the Board of Directors and within the Executive Commission of such Board.

Name of director	Reasons for resignation
Mr. Gonzalo Hinojosa Fernández de Angulo	The Director Mr. Gonzalo Hinojosa Fernández de Angulo, in order to refresh the Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on May 4, 2017, effective as of that date, from its position as Director of Telefónica, S.A., and thus from all of his position within the Board of Directors and within the Committees of such Board (member of the Executive Commission, of the Audit and Control Committee, of the Nominating, Compensation and Corporate Governance Committee, of the Service Quality and Customer Service Committee, of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee).

Name of director	Reasons for resignation
Mr. Pablo Isla Álvarez de Tejera	The Director Mr. Pablo Isla Álvarez de Tejera, in order to refresh the Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on May 4, 2017, effective as of that date, from its position as Director of Telefónica, S.A., and thus from all of his position within the Board of Directors and within the Committees of such Board (member of the Nominating, Compensation and Corporate Governance Committee).

	Reasons for resignation
Mr. Julio Linares López	The Director Mr. Julio Linares López, in order to facilitate the transformation process of the company and of its Board of Directors, formally stated his voluntary resignation to the Board of Directors, at its meeting held on July 26, 2017, effective as of that date, from its position as Director of Telefónica, S.A., and thus from all of his position within the Board of Directors and within the Committees of such Board (Chairman of the Regulation and Institutional Affairs Committee, member of the Service Quality and Customer Service Committee, and of the Strategy and Innovation Committee).

Name of director	Reasons for resignation
Mr. Antonio Massanell Lavilla	The Director Mr. Antonio Massanell Lavilla presented, by means of a written document dated December 21, 2017, and effective as of that date, his voluntary resignation, for personal reasons (retirement), from its position as Director of Telefónica, S.A., and thus from all of his position within the Board of Directors and within the Committees of such Board (Chairman of the Service Quality and Customer Service Committee, member of the Audit and Control Committee, of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee).

C.1.10 Indicate what powers, if any, have been delegated to the Chief Operating Officer:

Name or corporate name of director	Brief description
Mr. 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 all the powers of the Board of Directors, except those that cannot be delegated by Law, by the Corporate Bylaws, or by the Regulations of the Board of Directors which establishes, in Article 5.4, the powers that the Board of Directors reserves itself, and may not delegate.

Name or corporate name of director	Brief description
D. 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.

C.1.11 List the directors, if any, who hold office as directors or executives in other companies belonging to the listed company's group:

Name or corporate name of director	Corporate name of the group company	Position	Does he or she have executive functions?
Ms. Eva Castillo Sanz	Telefónica Deutschland Holding, AG	Chairwoman of Supervisory Board	No
Mr. Peter Erskine	Telefónica Deutschland Holding, AG	Member of Supervisory Board	No
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director	No
	Telefónica de Argentina, S.A.	Director	No
	Telefónica Brasil, S.A.	Director	No
	Telefónica Móviles de México, S.A. de C.V.	Director	No
Mr. Francisco Javier de Paz Mancho	Telefónica Ingeniería de Seguridad, S.A.	Chairman	No

C.1.12 List any company board members who sit on the boards of directors of other non-group companies that are listed on official securities markets in Spain, insofar as these have been disclosed to the company:

Name or corporate name of director	Name of listed company	Position
Ms. Eva Castillo Sanz	Bankia, S.A.	Director
Mr. José Javier Echenique Landiríbar	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	Gas Natural SDG, S.A.	Chairman
	The Bank of East Asia	Director
	Suez Environnement Company	Director
Mr. Luiz Fernando Furlán	Brasil Food, S.A. (BRF)	Director
Mr. Peter Löscher	Sulzer AG	Chairman
	OMV Aktiengesellschaft	Chairman
Mr. Ignacio Moreno Martínez	Obrascón Huarte Lain (OHL), S.A.	Director
Mr. Francisco José Riberas Mera	Gestamp Automoción, S.A.	Chairman
	CIE Automotive, S.A.	Director
	Global Dominion Access, S.A.	Director
Mr. Wang Xiaochu	China United Network Communications Limited	Chairman
	China Unicom (Hong Kong) Limited	Chairman - CEO

C.1.13 Indicate and, where appropriate, explain whether the Board Regulations establish rules about the maximum number of company boards on which its directors may sit:

Yes

Explanation of rules
As set forth in Article 28.2 of the Regulations of the Board of Directors, the Directors will devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors. In this regard, persons who belong to over five Board of Directors of other corporations other than Telefónica, S.A. and its Group companies cannot be appointed as Directors. For these purposes, a) all the Boards of companies which form part of the same Group will be counted as a single Board; and b) Boards of asset-holding companies or companies which are vehicles or complements for the Director's own professional activity, of his/her spouse or person with an analogous affective relationship, or his/her closest relatives, will not be counted. On an exceptional basis, for justified reasons, the Board will be able to exempt the Director from this prohibition.

C.1.14 Section eliminated.

C.1.15 List the total remuneration paid to the Board of Directors in the year:

Board remuneration (thousands of euros)	10,829
Amount of total remuneration by current directors in accumulated pension rights (thousands of euros)	78,789
Amount of total remuneration by former directors in accumulated pension rights (thousands of euros)	473

C.1.16 List any members of senior management who are not executive directors and indicate total remuneration paid to them during the year:

Name or corporate name	Position(s)
Mr. Ramiro Sánchez de Lerín García-Ovies	General Secretary and of the Board of Directors
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 (CCDO)
Mr. Juan Francisco Gallego Arrechea	General Manager of Internal Audit

Total remuneration received by senior management (in thousands of euros)	8,814

C.1.17 List, if applicable, the identity of those directors who are likewise members of the boards of directors of companies that own significant holdings and/or group companies:

Name or corporate name of director	Name or corporate name of significant shareholder	Position
-	-	-

List, if appropriate, any relevant relationships, other than those included under the previous heading, that link members of the Board of Directors with significant shareholders and/or their group companies:

Name or company name of director with relationship	Name or company name of significant shareholder with relationship	Description of relationship
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Early retirement. Formerly General manager of Wholesale and Investment Banking
Ms. Sabina Fluxà Thienemann	Banco Bilbao Vizcaya Argentaria, S.A.	Member of Regional Advisory Board
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office

C.1.18 Indicate whether any changes have been made to the board regulations during the year:

No

C.1.19 Indicate the procedures for appointing, re-electing, appraising and removing directors. List the competent bodies and the processes and criteria to be followed for each procedure.

See heading H “Other information of interest”, Note 15 to Section C.1.19.

C.1.20 Explain, if applicable, to what extent this annual evaluation of the Board has prompted significant changes in its internal organization and the procedures applicable to its activities:

Outline of changes
In a meeting on February 21, 2017, the Nominating, Compensation and Corporate Governance Committee revised and analysed the results of the Directors of Telefónica, S.A.'s evaluation in 2016 of the Board of Directors and its Committees and of the Company's General Meeting, concluding that, on the whole, they were highly satisfied with the organisation and activities of these governing bodies. Furthermore, and as a result of this Evaluation, certain improvement points were identified. In view of this and after an exhaustive examination and analysis of the results obtained, the Board followed the Nominating, Compensation and Corporate Governance Committee's proposal and approved the suggested improvements described hereon in order to optimize the operation of the Company's governing bodies: i. Continue with the implementation of measures and actions that allow for an optimum performance of the General Shareholder's Meeting. ii. Evaluate the inclusion of more presentations on the agenda of the Board of Directors and of the Executive Commission related to the strategy, products and commercial services of the Company, so that they can be subject to debate by the Board Members.

C.1.20.bis Describe the evaluation process and the evaluated areas performed by the Board of Directors, assisted, if applicable, by an external advisor, with regard to diversity in the Board's composition and skills, in the functioning and composition of its Committees, the performance of the Chairman of the Board of Directors and the company CEO, and each Director's performance and contribution.

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 work has been done in two parts; the first, related to the regulatory compliance of the law, review incorporated in the Good Governance Reputation Index (IRBG for its Spanish original), and the “Synthetic IRBG”, or comparative analysis of Telefónica with benchmark corporations in good governance.

The Good Governance Reputation Index (IRBG) is an empirical model of assessment and corporate government improvement that, based on Spanish legal regulations together with the legal regulations of the main western countries, makes it possible to quantify the degree of compliance of the indicators that make up this index. Specifically, 37 corporate governance indicators have been assessed; these indicators are grouped into the following nine variables: (i) Breakdown of the Board of Directors; (ii) Functioning of the Board of Directors; (iii) Committees of the Board of Directors; (iv) Remunerations and Performance; (v) Participation in the General

Meeting of Shareholders; (vi) Transparency; (vii) Anti-corruption and Fraud; (viii) Self-regulation and Corporate Social Responsibility; and (ix) Prevention and Treatment of Conflicts of Interest.

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.

C.1.20.ter Details, if applicable, of the business relations which the consulting firm or any Group company has with the company or any company in its group.

The external consultant has maintained business relationships for a total amount of 119,003.5 Euro for the execution of other work to Telefónica Group Companies.

C.1.21 Indicate the cases in which directors must resign.

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and 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 fulfil any of their obligations as Directors.

d) When their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardise its interests.

The conditions listed above under Recommendation C.1.19 (“Removal”) above must also be taken into consideration.

C.1.22 Section eliminated.

C.1.23 Are qualified majorities, other than legal majorities, required for any type of decisions?

No

If applicable, describe the differences.

C.1.24 Indicate whether there are any specific requirements, apart from those relating to the directors, to be appointed Chairman of the Board of Directors.

Yes

Description of requirements
In 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 favourable vote of at least 85 percent of the members of the Board of Directors.

C.1.25 Indicate whether the Chairman has the casting vote:

No

C.1.26 Indicate whether the Bylaws or the regulations of the Board of Directors set any age limit for directors:

No

C.1.27 Indicate whether the Bylaws or the regulations of the Board of Directors set a limited term of office for independent directors:

No

C.1.28 Indicate whether the Bylaws or board regulations stipulate specific rules on appointing a proxy to the board, the procedures thereof and, in particular, the maximum number of proxy appointments a director may hold. Also provide details if any restriction in the categories in which a proxy may be delegated has been established, beyond the restrictions imposed by applicable legislation. If so, give brief details.

In accordance with Article 19 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavour to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Non-executive Directors may only delegate their proxy in another non-executive Director. Such proxies may be granted by letter or any other means that, in the Chairman's opinion, ensures the certainty and validity of the proxy granted.

Article 34.4 of the Bylaws also establishes that all Directors who are absent may grant a proxy in writing to another Director who is in attendance, with the right to speak and to vote, at the meeting or session to which the proxy refers. The Director granting the proxy shall endeavour, to the extent possible, to include voting instructions in the proxy document.

C.1.29 Indicate the number of Board meetings held during the year and how many times the board has met without the Chairman's attendance. Attendance will also include proxies appointed with specific instructions.

Number of Board meetings	13
Number of Board meetings held without the Chairman's attendance	0

If the Chairman is a non-executive Director, indicate the number of meetings held, without attendance or proxy of any executive Director and under the Chairmanship of the Lead Independent Director.

Number of meetings	0

Indicate the number of meetings of the various board committees held during the year.

Executive Commission	16
Audit and Control Committee	12
Nominating, Compensation and Corporate Governance Committee	11
Service Quality and Customer Service Committee	5
Regulation and Institutional Affairs Committee	11
Strategy and Innovation Committee	11

C.1.30 Indicate the number of board meetings held during the year with all members in attendance. Attendance will also include proxies appointed with specific instructions.

Directors' attendance	13
% of attendances of the total votes cast during the year	100.00%

C.1.31 Indicate whether the consolidated and individual financial statements submitted for authorization by the board are certified previously:

No

Identify, where applicable, the person(s) who certified the company's individual and consolidated financial statements prior to their authorization for issue by the board.

C.1.32 Explain the mechanisms, if any, established by the Board of Directors to prevent the individual and consolidated financial statements it prepares from being submitted to the General Shareholders Meeting with a qualified Audit Report.

Through the Audit and Control Committee, the Board of Directors plays an essential role in supervising the preparation of the Company's financial information, controlling and coordinating the various players that participate in this process.

To achieve this objective, the Audit and Control Committee's work addresses the following basic issues:

A. Supervise internal audit and, in particular:

a) Safeguard the independence and efficiency of the internal audit function;

b) Propose the selection, appointment and removal of the person responsible for internal audit;

c) Propose the budget for such service;

d) Review the internal audit work plan and its annual activities report;

e) Receive regular information on its activities; and

f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.

B. Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.

C. Monitoring the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal risks, and discuss with the auditors significant weaknesses in the internal control system detected during the audit, without compromising their independence at any time. For that purposes, if deemed necessary, it can submit recommendations or proposals to the Board of Directors and an appropriate monitoring period. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:

a) The types of risk (operational, technological, financial, legal and reputational) facing the Company;

b) The risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialise; and

c) The control and information systems to be used to control and manage these risks.

D. Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could 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, the Committee has reviewed the non-financial and diversity information prepared by the Company in accordance to what is established by Royal Decree 18/2017 of 24 November which modifies the Code of Commerce, the consolidated text of the Corporate Enterprises Act, and the Accounts Auditing Act in terms of non-financial and diversity information. To this effect, the Audit and Control Committee meets whenever appropriate, having held twelve (12) meetings in the course of 2017.

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.1.33 Is the Secretary of the Board also a Director?

No

If the Secretary is not a member of the Board, fill in the following table:

Name or corporate name of Secretary	Representative
Mr. Ramiro Sánchez de Lerín García-Ovies	—

C. 1.34 Section eliminated.

C.1.35 Indicate, where applicable, the specific mechanisms implemented by the company to preserve the independence of the auditor, financial analysts, investment banks and rating agencies.

With regards to the independence of the External Auditor of the Company, Article 40 of the Regulations of the Board of Directors establishes that the Board shall, through the Audit and Control Committee, establish a stable and professional relationship with the Company's Auditor, strictly respecting the independence thereof.

The Audit and Control Committee has a fundamental responsibility, as specified in Article 22 of the Regulations of the Board, to establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardise the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualised information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.

The Committee must also issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion as to whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in the section above, considered individually and as a whole, other than legal audit and in relation to the regime of independence or laws regulating auditing activities.

Article 22 of the Regulations of the Board of Directors stipulates that the Audit and Control Committee submits proposals for the selection, appointment, re-election and replacement of the external auditor to the Board of Directors, and that it shall be held responsible for the selection process in accordance with prevailing laws, and also the conditions for recruiting the external auditor, regularly gathering information about the audit plan and its execution from the auditor, as well as safeguarding its independence in exercising its functions.

Furthermore, the External Auditor has direct access to the Audit and Control Committee and participates regularly in its meetings, in the absence of the Company's management team when this is deemed necessary. To this effect, and in keeping with US legislation on this matter, the External Auditor must inform the Audit and Control Committee at least once a year on the most significant generally accepted auditing policies and practices followed in the preparation of the Company's financial and accounting information affecting key elements in the financial statements which may have been discussed with the management team, and of all relevant communications between the Auditor and the Company's management team. Likewise, as established in Article 40 of the Regulations of the Board of Directors, every year the Auditor will have a meeting with the Board of Directors in plenary session to inform it of the work conducted and about the pattern of the Company's accounting and risks situation.

In accordance with internal company regulations and in line with the requirements imposed by US legislation, the engagement of any service from the Company's External Auditors must always have the prior approval of the Audit and Control Committee. Moreover, the engagement of non-audit services must be done in strict compliance with the Auditing Act (Ley de Auditoría de Cuentas) and the Sarbanes-Oxley Act published in the United States and subsequent regulations. For this purpose, and prior to the engagement of the Auditors, the Audit and Control Committee studies the content of the work to be performed, evaluating any situations that may compromise the External Auditor's independence, and specifically supervises the percentage the fees paid for such services represent in the total revenue of the auditing firm. In this respect, the Company reports the fees paid to the External Auditor, including those paid for non-audit services, in its Notes to the Financial Statements, in accordance with prevailing legislation.

C.1.36 Indicate whether the company has changed its external audit firm during the year. If so, identify the incoming audit firm and the outgoing auditor:

Yes

Outgoing auditor: Ernst &Young, S.L. (from now on, Ernst & Young).

Incoming auditor: PricewaterhouseCoopers Auditores, S.L. (from now on, PwC).

Explain any disagreements with the outgoing auditor and the reasons for the same:

No

C.1.37 Indicate whether the audit firm performs other non-audit work for the company and/or its group. If so, state the amount of fees received for such work and the percentage they represent of the fees billed to the company and/or its group:

Yes

	Company	Group	Total
Non audit services (Thousands of euros)	236	726	962
	Company	**Group**	**Total**
Non audit services / Amount total services (%)	6.60	4.50	4.90

C.1.38 Indicate whether the audit report on the previous year's financial statements is qualified or includes reservations. Indicate the reasons given by the Chairman of the Audit Committee to explain the content and scope of those reservations or qualifications.

No

C.1.39 Indicate the number of consecutive years during which the current audit firm has been auditing the financial statements of the company and/or its group. Likewise, indicate how many years the current firm has been auditing the accounts as a percentage of the total number of years over which the financial statements have been audited:

	Company	Group
Number of consecutive years	1	1
	Company	**Group**
Number of years audited by current audit firm/ Number of years the company's financial statements have been audited (%)	2.90	3.70

C.1.40 Indicate and give details of any procedures through which directors may receive external advice:

Yes

Procedures
Article 27 of the Regulations of the Board of Directors stipulates that in order to receive assistance in the performance of their duties, the Directors or any of the Committees of the Board may request that legal, accounting, financial or other experts be retained at the Company's expense. The engagement must necessarily be related to specific problems of a certain significance and complexity that arise in the performance of their duties. The decision to retain such services must be communicated to the Chairman of the Board of Directors and shall be formalised through the Secretary to the Board, unless the Board of Directors does not consider such engagement to be necessary or appropriate.

C.1.41 Indicate whether there are procedures for directors to receive the information they need in sufficient time to prepare for meetings of the governing bodies:

Yes

Procedures
The Company adopts the measures necessary, 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 organises the debates, promoting and encouraging all Directors to play an active role in the deliberations, safeguarding their right to freely adopt their own position on all matters. Moreover, with the assistance of the Secretary, he shall ensure that the Directors are sent sufficient information to discuss the points set out in the agenda sufficiently in advance of the meeting. He also ensures that sufficient time is given over to discussing strategic matters, and shall encourage debate during meetings, safeguarding the Directors' right to adopt their positions freely on all points discussed. To provide all the information and clarifications necessary in relation to certain points deliberated, the Group's senior executive officers attend nearly all the Board and Committee meetings to explain the matters within their powers. Furthermore, and as a general rule, the Regulations of the Board of Directors (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 channelled through the Chairman or Secretary to the Board of Directors, who shall respond to the requests made by the Directors, providing them with the requested information directly or offering them the proper contacts at the appropriate level of the organisation.

C.1.42 Indicate and, where appropriate, give details of whether the company has established rules obliging directors to inform the board of any circumstances that might harm the organization's name or reputation, tendering their resignation as the case may be:

Yes

Details of rules
In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalise such resignation when their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardises its interests. Likewise, Article 30.h) of the Regulations establishes that Directors must report to the Board any circumstances related to them that might damage the credit or reputation of the Company as soon as possible.

C.1.43 Indicate whether any member of the Board of Directors has notified the company that they have been indicted or tried for any of the offences stated in Article 213 of the Spanish Corporations Act:

No

Indicate whether the Board of Directors has examined this matter. If so, provide a justified explanation of the decision taken as to whether or not the director should continue to hold office or, if applicable, detail the actions taken or to be taken by the board.

C.1.44 List the significant agreements entered into by the company which come into force, are amended or terminate in the event of a change of control of the company due to a takeover bid, and their effects.

1. On April 29, 2013, Telefónica, S.A. and TLK Investment, CV (which belongs to Corporación Multi-Inversiones, or "CMI", a Business Group domiciled in Guatemala) signed an agreement whereby Telefónica and CMI incorporated a joint business venture called Telefónica Centroamérica Inversiones, S.L.U. ("TCI"), in which Telefónica contributed its assets in Central America (except for its Costa Rica assets) and CMI made a monetary contribution of USD 500,000,000. As a result of these contributions, Telefónica owns a 60% interest in the share capital of TCI, while CMI's stake is 40%. This arrangement was completed on August 2, 2013.

Telefónica and CMI also entered into a Shareholders' Pact in TCI, which includes a change of control clause stipulating that if there was a change of control of CMI or Telefónica, the other party would be fully entitled to: (i) exercise the right to acquire (call option) the entire stake held in TCI by the shareholder over which control has changed at the date control changed; or (ii) exercise the right to sell (put option) the entire stake the former held in TCI to the latter. In both cases, the purchase price of the stake shall be TCI's market value calculated by an independent expert.

For the purposes of the Shareholders' Pact, a change of control shall be: (i) in the case of CMI, when the last natural person or corporate body controlling CMI ceases to do so; and (ii) for Telefónica, when a natural person or corporate body not controlling Telefónica assumes control. In both instances, "control" shall be as specified in the International Financial Reporting Standards (IFRS).

2. - Financing agreements:

On February 19, 2015, Telefónica, S.A., as borrower, and a group of credit entities, as original lenders, with Citibank International Limited as the agent bank, entered into a syndicated loan amounting up to EUR 2,500 million. On the same date, Telefónica, S.A. executed a novation of another syndicated loan of up to EUR 3,000 million, formalized on February 18, 2014, with The Royal Bank of Scotland, PLC as the agent bank.

Likewise, on November 17, 2015, Telefónica, S.A. as borrower and a group of credit entities as original lenders, with Banco Bilbao Vizcaya Argentaria, S.A. as the agent bank, formalized a syndicated loan of up to EUR 3,000 million, which was modified on November 15, 2016 to reflect certain agreements reached between the parties with respect to its economic terms, including a reduction in its amount up to EUR 1,500 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 en España, 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.

On March 8, 2016, Telefónica, S.A., as borrower, Export Development Canada and AB Svensk Exportkredit, as original lenders, and Banco Bilbao Vizcaya Argentaria, S.A. Niederlassung Deutschland, as the agent, entered into a financing agreement amounting up to EUR 300 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.1.45 Identify, in aggregate form and provide detailed information on agreements between the company and its officers, executives and employees that provide indemnities for the event of resignation, unfair dismissal or termination as a result of a takeover bid or other.

Number of beneficiaries	31
Type of beneficiary Executive Directors, Senior Managers and other Employees	

Description of the resolution

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, mantain 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.

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.

Meanwhile, contracts that tie employees to the Company under a common employment relationship do not include indemnity clauses for the termination of their employment. In these cases, the employee is entitled to any indemnity set forth in prevailing labour legislation. However, contracts of some company employees, depending on their level and seniority, as well as their personal or professional circumstances or when they signed their contracts, establish their right to receive compensation in the same cases as in the preceding paragraph, generally consisting of a year and a half of salary. The annual salary on which the indemnity is based is the last fixed salary and the average amount of the last two variable payments received by contract.

Indicate whether these agreements must be reported to and/or authorized by the governing bodies of the company or its group:

	Board of Directors	General Shareholders Meeting
Body authorizing clauses	Yes	No

Is the General Shareholders' Meeting informed of such clauses?	Yes

C.2. Board committees

C.2.1 Give details of all the Committees of the Board of Directors, their members and the proportion of executive, proprietary, independent and other external directors:

EXECUTIVE COMMISSION

Name	Position	Professional category
Mr. 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 Landiríbar	Member	Independent
Mr. Peter Erskine	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of Executive Directors	28.57%
% of Proprietary Directors	28.57%
% of Independent Directors	42.86%
% of Other External Directors	0.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

The Board of Directors, always subject to the legal provisions in force, delegates all its powers to an Executive Commission, except those that cannot be delegated by Law, by the Corporate Bylaws, or by the Regulations of the Board of Directors.

The Executive Commission provides the Board of Directors with a greater efficiency and effectiveness in the execution of its tasks, since it meets more often.

Pursuant to the provisions of Article 38 of the Corporate Bylaws of Telefónica, S.A., Article 21 of the Regulations of the Board of Directors regulates the Executive Commission in the following terms:

a) Composition.

The Executive Commission shall consist of the Chairman of the Board of Directors, once appointed as a member of the Executive Commission, and not less than three or more than ten Directors appointed by the Board of Directors.

The Board of Directors shall seek to have External Directors constitute a majority over the Executive Directors.

In all cases, the affirmative vote of at least two-thirds of the members of the Board of Directors shall be required in order for the appointment or re-appointment of the members of the Executive Commission to be valid.

b) Operation.

The Executive Commission shall meet whenever called by the Chairman, and shall normally meet every fifteen days.

The Chairman and Secretary to the Board of Directors shall act as the Chairman and Secretary to the Executive Commission. One or more Vice Chairmen and a Deputy Secretary may also be appointed.

A valid quorum of the Executive Commission shall exist with the presence, in person or by proxy, of more than one-half of its members.

Resolutions shall be adopted by a majority of the Directors attending the meeting (in person or by proxy), and in the case of a tie, the Chairman shall cast the deciding vote.

c) Relationship with the Board of Directors.

The Executive Commission shall report to the Board in a timely manner on the matters dealt with and the decisions adopted at the meetings thereof, with a copy of the minutes of such meetings made available to the members of the Board (Article 21.C) of the Regulations of the Board of Directors).

Most significant actions during the year.

During the 2017 year, the Executive Commission of the Board of Directors of Telefónica, S.A. has analysed, reviewed, deliberated upon and adopted resolutions on a range of matters concerning, inter alia:

- The business activity performed by the Telefónica Group: i) products and services (E2E Digitalization, Internet of Things, Security B2B, Network, Terminals, Business Intelligence, Big Data, voice and data, video services, etc.), ii) business performance in the countries in which the Telefónica Group operates, and iii) operational trends.

- Status of regulations in the telecommunications sector (such as regulatory amendments and spectrum auctions).

- Corporate and financing transactions of the Telefónica Group.

Indicate whether the composition of the Executive Commission reflects the participation within the board of the different types of directors:

Yes

AUDIT AND CONTROL COMMITTEE

Name	Position	Professional category
Mr. 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 Proprietary Directors	25.00%
% of Independent Directors	75.00%
% of Other External Directors	0,00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 19 to Section C.2.1.

Indicate the Director who sits on the Audit Committee who has been appointed, taking into account his/her knowledge and experience in accounting, auditing or in both, and state how many years the Chairman of this Committee has held this position.

Name or Director with experience
Mr. José Javier Echenique Landiríbar
No. years Chairman has held this position
2

NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Position	Professional category
Mr. Francisco Javier de Paz Mancho	Chairman	Independent
Mr. José Javier Echenique Landiríbar	Member	Independent
Mr. Peter Erskine	Member	Independent
Ms. Sabina Fluxà Thienemann	Member	Independent
Mr. Luiz Fernando Furlán	Member	Independent

% of Proprietary Directors	0.00%
% of Independent Directors	100.00%
% of Other External Directors	0.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 20 to Section C.2.1.

SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Position	Type
Ms. Eva Castillo Sanz	Member	Other External
Ms. Carmen García de Andrés	Member	Independent
Mr. Ignacio Moreno Martínez	Member	Proprietary

% of Proprietary Directors	33.33%
% of Independent Directors	33.33%
% of Other External Directors	33.33%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 21 to Section C.2.1.

REGULATION AND INSTITUTIONAL AFFAIRS COMMITTEE

Name	Position	Professional category
Mr. Ignacio Moreno Martínez	Chairman	Propietary
Ms. Eva Castillo Sanz	Member	Other External
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of Proprietary Directors	33.33%
% of Independent Directors	33.33%
% of Other External Directors	33.33%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 22 to Section C.2.1.

STRATEGY AND INNOVATION COMMITTEE

Name	Position	Professional category
Mr. Peter Erskine	Chairman	Independent
Mr. José María Abril Pérez	Member	Propietary
Ms. Eva Castillo Sanz	Member	Other External
Mr. Juan Ignacio Cirac Sasturain	Member	Independent
Mr. Peter Löscher	Member	Independent

% of Proprietary Directors	20.00%
% of Independent Directors	60.00%
% of Other External Directors	20.00%

Explain the functions attributed to this committee, outline the procedures and rules for its organisation and working and summarise the most significant actions taken over the course of the year.

See heading H “Other information of interest”, Note 23 to Section C.2.1.

Action Plan and Report.

As for the Board itself, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, all Committees shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

All Committees shall also draw up an internal Activities Report summarizing the main activities and actions taken during the previous year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues addressed by the Committees.

C.2.2 Complete the following table on the number of female directors on the various board committees over the past four years:

	Number of female directors			
	2017 Number %	2016 Number %	2015 Number %	2014 Number %
Executive Commission	0	0	0	0
Audit and Control Committee	1 (25.00%)	0	0	0
Nominating, Compensation and Corporate Governance Committee	1 (20.00%)	1 (20.00%)	0	0
Service Quality and Customer Service Committee	2 (66.67%)	1 (20.00%)	1 (14.29%)	1 (14.29%)
Regulation and Institutional Affairs Committee	1 (33.33%)	1 (16.67%)	0	0
Strategy and Innovation Committee	1 (20.00%)	1 (14.29%)	0	0

C.2.3 Section eliminated.

C.2.4 Section eliminated.

C.2.5 Indicate, as appropriate, whether there are any regulations governing the board committees. If so, indicate where they can be consulted, and whether any amendments have been made during the year. Also indicate whether an annual report on the activities of each committee has been prepared voluntarily.

The organization and operation of the Board of Directors Committees 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 internal Activities Report summarising the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

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.

C.2.6 Section eliminated.

D. Related-party and intragroup transactions

D.1 Explain, if applicable, the procedures for approving related-party or intragroup transactions.

Procedure for reporting on approval of related-party transactions.

Article 5 of the Regulations of the Board of Directors includes a number of powers of the Board which cannot be delegated, including the following:

The approval, based on a favourable report by the Audit and Control Committee, of the transactions which the company carries out with directors, significant shareholders or representatives on the board, or related parties.

Also, as set forth in Article 30.f) of the Regulations of the Board of Directors, Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, on the recommendation of the Audit and Control Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors (present in person or by proxy).

Also, Article 38 of the Regulations of the Board of Directors specifically regulates transactions performed with significant shareholders, and establishes that the Board of Directors, based on a favourable report by the Audit and Control Committee, will approve the transactions which the Company or its Group perform with directors, individual or together with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other Group companies or with persons related to them, unless this power is attributable by law to the General Shareholders Meeting.

Directors affected or which represent or which are related to affected shareholders will have to refrain from taking part in the deliberation and voting on the resolution in question.

This approval does not include transactions which, according to prevailing laws, do not require such approval or exemption, i.e. according to Article 529 ter of the Spanish Corporations Act, the transactions which simultaneously fulfil the three following requirements:

1.º they are performed by virtue of contracts whose conditions are standardised and are applied on an across-the-board basis to a large number of clients,

2.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 List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's significant shareholders.

Name or corporate name of significant shareholder	Name or corporate name of the company or its group company	Nature of the relationship	Type of transaction	Amount (Thousands of euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	8,584
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	1,600
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest charged	19
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Others	11,371
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: loans	995,109
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees	313
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: other	1,208,971
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earning	127,782
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest paid	26,041
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	210
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	225
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest charged	28,474
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Management contracts	586
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	37,562
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	4,440
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Others	6,525
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance arrangements: loans	42,402
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees	221,548
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	217
Banco Bilbao Vizcaya Argentaria, S.A	Rest of Telefónica Group	Contractual	Operating lease contracts	15
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Interest paid	3,974
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Receipt of services	1,522
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: loans	291,813

CaixaBank, S.A.	Telefónica, S.A.	Contractual	Guarantees	8,230
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: other	413,580
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	104,350
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Interest paid	779
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	7,027
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Services rendered	70,685
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	43,248
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	14,432
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Guarantees	42,736
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	85,427
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Other	250,012
CaixaBank, S.A.	Rest of Telefónica Group	Contractual	Purchase of goods (finished or in progress)	55,647

D.3 List any relevant transactions, by virtue of their amount or importance, between the company or its group of companies and the company's managers or directors.

D.4 List any relevant transactions undertaken by the company with other companies in its group that are not eliminated in the process of drawing up the consolidated financial statements and whose subject matter and terms set them apart from the company's ordinary trading activities.

In any case, list any intragroup transactions carried out with entities in countries or territories considered to be tax havens.

D.5 Indicate the amount from other related-party transactions:

23,000 thousands euros

D.6 List the mechanisms established to detect, determine and resolve any possible conflicts of interest between the company and/or its group, and its directors, management or significant shareholders.

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

• 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 favourable report by the Audit and Control Committee, will approve the transactions which the Company or its Group perform with directors, individual or together with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other Group companies or with persons related to them, unless this power is attributable by law to the General Shareholders Meeting.

  This approval does not include transactions which, according to prevailing laws, do not require such approval or exemption, i.e. according to Article 529 ter of the Spanish Corporations Act, the transactions which simultaneously fulfil the three following requirements:

  1.º they are performed by virtue of contracts whose conditions are standardised and are applied on an across-the-board basis to a large number of clients,

  2.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.

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

No

Please specify the subsidiary companies listed in Spain:

Subsidiary company listed

Indicate whether they have provided detailed disclosure on the type of activity they engage in, and any business dealings between them, as well as between the subsidiary and other group companies:

Define possible business relations between the parent company and the listed subsidiary, and between the latter and the other Group companies

Indicate the mechanisms in place to resolve possible conflicts of interest between the listed subsidiary and other group companies:

Mechanisms to resolve possible conflicts of interest

E. Risk control and management systems

E.1 Describe the risk management system in place at the company, including with relation to taxes.

Telefónica continually monitors the most significant risks in the main companies comprising its Group. The Company therefore has a Corporate Risk Management Framework, based on the model established by the Treadway Commission's Committee of Sponsoring Organizations (COSO). In line with the continuous improvement of the Risk Management Framework, Telefonica will continue with the alignment of its framework with the new requirements of the updated COSO ERM Framework ("Enterprise Risk Management - Integrating with Strategy and Performance"), released in September 2017.

One of the features of this Framework is a map prioritizing risks according to their importance, thereby facilitating their management and an appropriate response to mitigate them. 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 responsible for preparing and implementing the risk management system, including tax matters.

Telefónica, S.A.'s Board of Directors reserves the power to approve the general risk policy. The Audit and Control Committee shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least: the categories of risks facing the Company, the setting of the risk level that the Company deems acceptable, the measures to mitigate the impact of the identified risks, and the control and information systems to be used to control and manage the above-mentioned risks. The powers and duties of the Audit and Control Committee also include the supervision of the Company's risk management system.

As stated by the Group's Risk Management Policy, various local and corporate units are involved in the risk management process.

The entire organization is responsible for contributing to the identification and management of risks, following the procedures defined to implement and ensure the effectiveness of the Group's risk management processes.

In order to coordinate and report these activities, there is an internal Risk Management function, within the Internal Audit department, reporting functionally to the Audit and Control Committee.

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 Indicate the main risks, including tax risks, which may prevent the company from achieving its targets.

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

E.4. State whether the company has a risk tolerance level, including tax risk.

The Company has a level of risk tolerance or acceptable risk level established at a corporate level. This threshold represents the extent to which it is prepared to assume a certain level of risk, insofar as it may contribute to generating value and developing the business, achieving an appropriate balance between growth, performance and risk.

The range of risks to which the Company may be exposed, described below, is considered when evaluating risk:

- Generally, albeit mainly related to operational and business risks, tolerance thresholds are defined pursuant to the impact and probability of the risk. These thresholds are revised annually based on the performance of the main financials for both the Group as a whole and the business lines and main companies therein.
- The tolerance level for financial risks (including fiscal risks) is set in terms of their economic impact.
- A zero-tolerance level is established for global risks, principally those affecting corporate reputation and responsibility.

E.5 Identify any risks, including fiscal risks, which have occurred during the year.

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

The Shareholders Meeting of Colombia Telecomunicaciones, S.A. E.S.P. -"ColTel"- (company with a direct or indirect investment by Telefónica of 67.5% and by the Colombian Government of 32.5%), approved on August 30, 2017 a capital increase for a total amount (capital and premium) of 1.651 billion Colombian pesos, approximately 472 million Euro at the exchange rate of said date, in order to make the payment of the amount set in the arbitral award issued in the arbitration begun by the Ministry of Information Technologies and Communications -"MinTIC" of Colombia, in relation to its claim that certain assets subject to the provision of services be reversed under old concessions. The aforementioned arbitral award was unfavourable for both ColTel and another telecommunications operator in Colombia. The Telefónica Group and the Nation subscribed said amount as a proportion of their respective share participations in ColTel, thus entailing a disbursement for the Telefónica Group of 1.114 billion Colombian pesos, approximately 318 million Euro at the exchange rate of said date.

Further details on Income tax matters are provided by Telefónica in its Financial Statements (Note 17).

E.6 Explain the response and monitoring plans for the main risks the company is exposed to, including fiscal risks.

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.

Given the diverse range of risks, the mechanisms for responding to risks include overarching initiatives that are developed and coordinated as standard across the Group's main operations and/or specific measures aimed at managing certain risks at company level.

Overarching measures, mainly involving the use of financial derivatives, are taken to mitigate certain financial risks such as those relating to exchange-rate and interest-rate fluctuations. Regarding fiscal risks, the key issues identified are monitored, the Group uses Multinational Programs for insurance or insurance arranged locally in each country to cover operational risks, depending on the type of risk and cover required.

F. Internal Control over Financial Reporting (ICFR) Systems

Describe the mechanisms which comprise the internal control over financial reporting (ICFR) risk control and management system at the company.

F.1 The company's control environment

Specify at least the following components with a description of their main characteristics:

F.1.1 The bodies and/or functions responsible for: (i) the existence and regular updating of a suitable, effective ICFR; (ii) its implementation; and (iii) its monitoring.

The Board of Directors of Telefónica, S.A. (hereinafter "Telefónica") assumes ultimate responsibility of ensuring that an adequate and effective 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, and in particular, 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 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 the significant weaknesses of the internal control system detected in the performance of the audit, all without breaking their independence. Therefore, where appropriate, it may submit recommendations or proposals to the Board of Directors and the corresponding deadline for 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) 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. Analyze 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 and in the terms established in the applicable regulations, 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 to be tax havens; and
3. Transactions with related parties.

x. To exercise, regarding those companies of its Group that are considered Public Interest Entities (as they are defined in the current legislation) for the approval of the Board of Directors, provided 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 of sections ii), vii) and viii) of this article 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 every month, and, additionally, every time it is considered appropriate.

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

All the different areas and functional units of the Telefónica Group are important in ICFR (internal control over financial reporting), the Strategy and Financial areas playing a key role, as they are responsible for preparing, maintaining and updating the different procedures that govern their operations and identify the tasks to be carried out, as well as the persons in charge for executing these tasks.

F.1.2 Whether the following components exist, especially in connection with the process for the preparation of the financial information reporting:

- **The departments and/or mechanisms in charge of: (i) the design and review of the organizational structure; (ii) defining clearly the lines of responsibility and authority, with an appropriate distribution of tasks and functions; and (iii) sufficient deploying procedures so this structure is communicated effectively throughout the company.**

The Board of Directors is responsible for designing and reviewing the Company's organizational structure, ensuring there is an adequate separation of functions and that satisfactory coordination mechanisms among the different areas are established. The Human Resources Division carries out the deployment 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**, 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, S.A. both in Spain and in the rest of the countries where Telefónica's shares are listed.

– **Manual for Completion of the Reporting for Consolidation of the Telefónica Group,** which is updated 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, approving body, dissemination and instruction degree, principles and values covered (stating whether it makes specific reference to the recording of operations and the preparation of financial information), body in charge of investigating breaches and proposing corrective or disciplinary action.**

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).

The Business Principles are based on a series of general criteria which concern honesty and trust, abidance by prevailing laws, integrity and respect for human rights. They also set out specific principles focused on ensuring the trust of customers, professionals, shareholders, suppliers and of society at large.

They expressly mention issues related to the recording of transactions and the preparation of financial information: "*We prepare financial and accounting records in an accurate and reliable manner*".

This Code of Ethics is accessible to all employees via the intranet, and procedures are in place in the Telefónica Group to update, monitor adherence to and disseminate these Business Principles.

Telefónica has an Office of Responsible Business Principles, which comprises the most senior representatives of the General Secretary's Office, Human Resources, Public Affairs and Regulation, CCDO, Operations, Purchases, Compliance, Internal Audit, Corporate Ethics and Sustainability, Security and 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.
- Analyze 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 labor laws, distinguishing between minor, serious and very serious sanctions, depending on the circumstances.

Training programmes are also regularly organized to ensure employees are aware of these rules and principles.

Telefónica also has an "Internal Code of Conduct" for Securities Markets issues, 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. The Board of Directors on its meeting held on December 14, 2016, approved a new version of the Internal Code of Conduct in order to adapt it to the regulatory changes on this matter.

- **Whistle-blowing channel, for the reporting to the Audit Committee of any irregularities of a financial or accounting nature, as well as breaches of the code of conduct and malpractice within the organisation, stating whether reports made through this channel are confidential.**

With regard to the whistle-blowing channel, as specified in Article 22 of Telefónica, S.A.'s Regulations for the Board of Directors, 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 two main whistle-blowing channels:

SOX Whistle-blowing Channel: this channel was approved by the Audit and Control Committee in April 2004 to fulfil the obligations laid down in the Sarbanes-Oxley Act (SOX), as a listed company on the New York Stock Exchange. It is open to all Telefónica Group employees. Any irregularities reported through the channel must only be related with financial-accounting information, internal controls thereof, and/ or audit-related matters.

This channel is confidential and anonymous, since the contents of any reports are sent automatically to the Compliance Department, removing the sender's name, and the source of the message cannot be traced in any event.

The channel is accessible through the Internal Audit webpage on Telefónica's intranet, through the section: Rules of Telefónica's Group, Control over the financial report process.

The Compliance and Internal Audit Departments, as delegate areas of the Audit and Control Committee of Telefónica, S.A., to these purposes, receive all complaints made through this channel regarding internal controls, accounting or the audit of the financial statements, therefore these Departments will be aware of these complaints, will solve them or give each of these complaints the treatment they deem convenient, analyzing the effects if any, they may have in relation to internal control over financial information, as well as monitoring the corresponding remediation plans.

Business Principles Whistle-blowing Channel: through this channel, professionals can notify the Company of any behavior, actions or events that could breach the ethical code, the Company's internal rules, or any regulations governing its activity, and jeopardize the contractual relationship between the Company and the accused party. Questions, advice and information on compliance with the Business Principles and associated policies and rules can also be submitted through this channel.

As a general rule, the policy of the Business Principles Whistle-blowing Channel is not to promote anonymous messages. Notwithstanding the foregoing, the confidentiality of the complainant's identity is safeguarded at all times.

Telefónica S.A.'s Compliance Department is responsible for the Responsible Business Principles Whistle-blowing Channel.

- **Training and refresher courses for personnel involved in preparing and reviewing financial information or evaluating ICFR, which address, at least, accounting rules, auditing, internal control and risk management.**

With regard to employee training in financial and control issues, we would note that in 2007 the Telefónica Corporate University (Universitas Telefónica) was opened to help contribute to the Telefónica Group's advancement through lifelong learning. All the University's training programs are based on developing the corporate culture, the business strategy and management and leadership skills.

Likewise, the 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 which includes a finance school providing specific training and refresher courses on financial information, as well as an internal control school providing instruction on auditing, internal control and risk management.

F.2. Risk assessment in financial reporting

Report, at least:

F.2.1 The main characteristics of the risk identification process, including risks of error or fraud, stating whether:

- **The process exists and is documented.**

Given the vast number of processes involved in financial reporting at the Telefónica Group, a model has been developed to select the most significant processes by applying a so-called Scope Definition Model, which is 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 accounts, 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 processes have been identified, the risks that may potentially have an impact on financial reporting are analyzed.

- **The process covers all financial reporting objectives, (existence and occurrence; completeness; valuation; presentation, disclosure and comparability; and rights and obligations), is updated and with what frequency.**

This identification procedure covers all the financial reporting objectives of existence and occurrence, completeness, valuation, presentation, disclosure and fraud. Risk identification is carried out on an annual basis.

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- **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.**

As indicated above, Telefónica also has a Risk Management Model covering four key areas of risk:

- Business risks
- Operational risks
- Global risks (Sustainability and Compliance)
- Financial risks

- **Which of the company's governing bodies is responsible for overseeing the process.**

Pursuant to the provisions of Article 22 of the Regulation of the Board of Directors of Telefónica, S.A., the Board of Directors, through the Audit and Control Committee, supervises this process.

F.3 Control activities.

Indicate the existence of at least the following components, and specify their main characteristics:

F.3.1 Procedures for reviewing and authorizing the financial information and description of ICFR to be disclosed to the markets, stating who is responsible in each case and documentation and flow charts

of activities and controls (including those addressing the risk of fraud) for each type of transaction that may materially affect the financial statements, including procedures for the closing of accounts and for the separate review of critical judgments, estimates, evaluations and projections.

On March 26, 2003 Board of Directors of Telefónica, S.A. approved the "Regulations Governing Disclosure and Reporting to the Markets". These regulate the basic principles of operation of the financial disclosure control processes and systems which guarantee that all relevant consolidated financial information of Telefónica, S.A. is communicated to the Company's senior executives and its management team, assigning to the Internal Audit the duty of periodically assessing the functioning of these processes and systems.

Each quarter the Consolidation and Accounting Polices 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 Polices 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 Polices 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 Polices 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 others 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, continuity and segregation of duties) giving support to key company processes regarding the preparation and publication of financial information.

The Global Networks and Information Systems Department of the Telefónica Group is responsible for the global management of Information Systems for all the Group's businesses, defining strategy and technological planning, ensuring quality in service, cost and security required by the Group.

One of its duties is to develop and implement systems to improve the efficiency, efficacy and profitability of Group processes, the definition and implementation of policies and security standards for applications and infrastructures (in conjunction with the Global Security Department), which includes IT aspects of the internal control model.

The Global Security Policy considers human resources, the information, the technological and material resources that support them, to be fundamental assets. For this reason, guaranteeing their security is considered to be an essential asset 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.

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, Corresponsibility, 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. In order 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 the purpose of reaching a standardized level of security. This framework will take into account 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 in order 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 Corresponsibility**: 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**: in order 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 in order 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 Teléfonica, 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 as regards the methods and main hypothesis used, is verified directly by the area contracting the service and, if applicable with the procurement department. The 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 in order to ensure compliance of the outsourced process according to the Group's different policies and guidelines.

Likewise, there is an internal procedure for engaging independent experts which requires specific levels of approval.

F.4 Information and communication

Indicate the existence of at least the following components, and specify their main characteristics:

F.4.1 A specific function in charge of defining and maintaining accounting policies (accounting policies area or department) and settling doubts or disputes over their interpretation, which is in regular communication with the team in charge of operations, and a manual of accounting policies regularly updated and communicated to all the company's operating units.

The Consolidation and Accounting Polices 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. This bulletins are published on a monthly basis.

Also, the Telefónica Group has an Accounting Policies Manual which is updated annually, the last update took place in December 2017. The objectives of this manual are: to align the corporate accounting principles and policies with IFRS; to maintain accounting principles and policies which ensure that the information is comparable within the Group and offers optimum management of the source of information; to improve the quality of the accounting information of the various Group companies and of the Consolidated Group by disclosing, agreeing and introducing accounting principles which are unique to the Group; and to facilitate the accounting integration of acquired and newly-created companies into the Group's accounting system by means of a reference manual.

This Manual is mandatory for all companies belonging to the Telefónica Group, and shall be applied to their reporting methods when preparing the consolidated financial statements.

This documentation is regularly sent by email and is available for the entire Group on the Telefónica intranet.

The accounting policies area maintains a constant dialogue with the accounting heads of the Group's main operations, both proactively and reactively. This dialogue is useful not only for resolving doubts or conflicts but also to ensure that accounting criteria in the Group are uniform and also for sharing best practices between operators.

F.4.2 Mechanisms in standard format for the capture and preparation of financial information, which are applied and used in all units within the entity or group, and support its main financial statements and accompanying notes as well as disclosures concerning ICFR.

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 beforehand, the Corporate Bylaws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties, with its main functions including: supervising the effectiveness of the Company's internal control system and risk management systems, and discussing with the Auditors significant or material weaknesses in the internal control system detected during the audit.

The Audit and Control Committee is responsible for supervising the effectiveness of the internal controls carried out by the Telefónica Group's Internal Audit function.

The Internal Audit function reports functionally to the Audit and Control Committee, with the primary goal of lending them support in their responsibilities concerning ensuring governance, risk management, and the Group's Internal Control System. Internal Control comprises all process which may reasonably ensure compliance with laws, regulations and internal rules, reliability of information, efficiency and efficacy of operations, and the integrity of the organisation's net worth.

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 above mentioned 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.

In this regard, the External Auditor issues its own independent opinion on the effectiveness of the internal control over financial information (ICFR).

Additionally, to fulfil this requirement, the Telefónica Group uses a three-tier (next detailed) internal control of financial reporting evaluation model, while every year the Internal Audit function is responsible for evaluating its performance.

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, analyzing 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 weaknesses found.

As explained beforehand, the Internal Audit unit also provides support to the Audit and Control Committee in monitoring the correct functioning of the ICFR system.

The Internal Audit unit participates in the Audit and Control Committee meetings, and reports regularly on the findings of the performed tasks, as well as action plans established to mitigate and of the degree of implementation thereof. This includes to communicate significant or material internal control weaknesses which have been identified.

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. Degree of Compliance with Corporate Governance Recommendations

Indicate the extent to which the company follows the recommendations of the Good Governance Code of listed companies.

Should any recommendation not be followed or be only partially followed, a detailed explanation should be given of the reasons so that the shareholders, investors and the market in general have sufficient information to assess the way the company works. General explanations will not be acceptable.

1. **The bylaws of listed companies should not place an upper limit on the votes that can be cast by a single shareholder, or impose other obstacles to the takeover of the company by means of share purchases on the market.**

   Explain

   In accordance with Article 26 of the Corporate Bylaws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 percent voting ceiling.

   The limitation established in the preceding paragraphs shall also apply to the maximum number of votes that may be collectively or individually cast by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or corporate shareholder and the entity or entities that are shareholders themselves and which are directly or indirectly controlled by such individual or corporate shareholder.

   In addition, Article 30 of the Corporate Bylaws stipulates that no person may be appointed as Director unless they have held, for more than three years prior to their appointment, a number of shares of the Company representing a nominal value of at least 3,000 euros, which the Director may not transfer while in office. These requirements shall not apply to those persons who, at the time of their appointment, are related to the Company under an employment or professional relationship, or when the Board of Directors resolves to waive such requirements with the favorable vote of at least 85 percent of its members.

   Article 31 of the Corporate Bylaws establishes that, in order for a Director to be appointed Chairman, Vice-Chairman, Chief Executive Officer or member of the Executive Commission, it shall be necessary for such Director to have served on the Board for at least the three years immediately prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

   The Corporate Bylaws (Article 26) restrict the number of shares that may be cast by a single shareholder or by shareholders belonging to the same group in order to achieve a suitable balance and protect the position of minority shareholders, thus avoiding a potential concentration of votes among a reduced number of shareholders, which could impact on the guiding principle that the General Shareholders' Meeting must act in the interest of all the shareholders. Telefónica believes that this measure does not constitute a blocking mechanism of takeover bids but rather a guarantee that the acquisition of control required the majority support of all shareholders, because, naturally, and as taught by experience, potential offerors may make their offer conditional upon the removal of the defense mechanism.

   In relation to the above and in accordance with the provisions of Article 527 of the Spanish Corporations Act, any clauses in the Bylaws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will rendered null and void when, subsequent to a takeover bid, the offeror has a stake equal to or over 70% of the share capital which confers voting rights, unless the offeror was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

In addition, the special requirements for appointment as Director (Article 30 of the Corporate Bylaws) or as Chairman, Vice-Chairman, Chief Executive Officer or member of the Executive Commission (Article 31 of the Corporate Bylaws) are justified by the desire that access to the management decision-making body and to the most significant positions thereon is reserved to persons who have demonstrated their commitment to the Company and who, in addition, have adequate experience as members of the Board, such that continuity of the management model adopted by the Telefónica Group may be assured in the interest of all of its shareholders and stakeholders. In any event, these special requirements may be waived by broad consensus among the members of the Board of Directors, namely, with the favorable vote of at least 85 percent of its members, as provided by the aforementioned Articles of the Corporate Bylaws.

2. When a dominant and a subsidiary company are both listed, they should provide detailed disclosure on:

a) The activity they engage in and any business dealings between them, as well as between the listed subsidiary and other group companies.

b) The mechanisms in place to resolve possible conflicts of interest.

Not applicable

3. During the annual general meeting the Chairman of the Board should verbally inform shareholders in sufficient detail of the most relevant aspects of the company’s corporate governance, supplementing the written information circulated in the Annual Corporate Governance Report. In particular:

a) Changes taking place since the previous annual general meeting.

b) The specific reasons for the company not following a given Good Governance Code recommendation and any alternative procedures followed in its stead.

Complies

4. The company should draw up and implement a policy of communication and contacts with shareholders, institutional investors and proxy advisors that complies in full with market abuse regulations and accords equitable treatment to shareholders in the same position.

This policy should be disclosed on the company's website, complete with details of how it has been put into practice and the identities of the relevant interlocutors or those charged with its implementation.

Complies

5. **The Board of Directors should not make a proposal to the general meeting for the delegation of powers to issue shares or convertible securities without pre-emptive subscription rights for an amount exceeding 20% of capital at the time of such delegation.**

   When a board approves the issuance of shares or convertible securities without pre-emptive subscription rights, the company should immediately post a report on its website explaining the exclusion as envisaged in company legislation.

   Complies

6. **Listed companies drawing up the following reports on a voluntary or compulsory basis should publish them on their website well in advance of the annual general meeting, even if their distribution is not obligatory:**

   a) **Report on auditor independence.**

   b) **Reviews of the operation of the Audit Committee and the Nomination and Remuneration Committee.**

   c) **Audit Committee report on third-party transactions.**

   d) **Report on corporate social responsibility policy.**

   Complies

7. **The company should broadcast its general meetings live on the corporate website.**

   Explain

   The Company decided not to offer a live webcast of its 2017 General Shareholders Meeting, for organisational reasons and owing to the way the Meeting was developed (possible changes which could arise). Nonetheless, Telefónica is analysing the possibility of broadcasting future General Shareholders meetings live on its website.

8. **The Audit Committee should strive to ensure that the Board of Directors can present the company's accounts to the general meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the Chairman of the Audit Committee and the auditors should give a clear account to shareholders of their scope and content.**

   Complies

9. **The company should disclose its conditions and procedures for admitting share ownership, the right to attend general meetings and the exercise or delegation of voting rights, and display them permanently on its website.**

   Such conditions and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner.

   Complies

10. **When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the general meeting, the company should:**

a) **Immediately circulate the supplementary items and new proposals.**

b) **Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the Board of Directors.**

c) **Put all these items or alternative proposals to the vote applying the same voting rules as for those submitted by the Board of Directors, with particular regard to presumptions or deductions about the direction of votes.**

d) **After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.**

Not applicable

11. **In the event that a company plans to pay for attendance at the general meeting, it should first establish a general, long-term policy in this respect.**

Not applicable

12. **The Board of Directors should perform its duties with unity of purpose and independent judgement, according the same treatment to all shareholders in the same position. It should be guided at all times by the company's best interest, understood as the creation of a profitable business that promotes its sustainable success over time, while maximising its economic value.**

In pursuing the corporate interest, it should not only abide by laws and regulations and conduct itself according to principles of good faith, ethics and respect for commonly accepted customs and good practices, but also strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.

Complies

13. **The Board of Directors should have an optimal size to promote its efficient functioning and maximize participation. The recommended range is accordingly between five and fifteen members.**

Explain

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. The Board of Directors should approve a Director selection policy that:

a) Is concrete and verifiable.

b) Ensures that the appointment or reelection proposals are based on a prior analysis of the Board's needs.

c) Favours a diversity of knowledge, experience and gender.

The results of the prior analysis of board needs should be written up in the Nomination Committee's explanatory report, to be published when the general meeting is convened that will ratify the appointment and re-election of each Director.

The director selection policy should pursue the goal of having at least 30% of total board places occupied by women Directors before the year 2020.

The Nomination Committee should run an annual check on compliance with the director selection policy and set out its findings in the Annual Corporate Governance Report.

Complies

15. Proprietary and independent Directors should constitute an ample majority on the Board of Directors, while the number of Executive Directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.

Complies

16. The percentage of Proprietary Directors out of all Non-executive Directors should be no greater than the proportion between the ownership stake of the shareholders they represent and the remainder of the company's capital.

This criterion can be relaxed:

a) In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.

b) In companies with a plurality of shareholders represented on the Board but not otherwise related.

Explain

The aforementioned recommendation 16 refers to the composition of the group of non executive Directors. As stated in Section C.1.3 of this Annual Corporate Governance Report, at December 31, 2017, the group of non Executive Directors of Telefónica, S.A. was composed of 14 members (of a total of 16 Members), of whom 4 are Proprietary Directors, 9 are Independent Directors and 1 falls under the "Other External Directors" category.

At December 31, 2017, of the four Proprietary Directors, one act in representation of CaixaBank, S.A., which holds 5.01% of the capital of Telefónica, S.A., two act in representation of Banco Bilbao Vizcaya

Argentaria, S.A. (BBVA), which holds 5.17% of the capital, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds a 1.24% stake.

Applying the proportional criterion established in Article 243 of the LSC regarding the total number of Directors, the stakes held by "la Caixa" and BBVA are sufficient to entitle each entity to appoint a Director.

Moreover, it must be taken into account that recommendation 16 stipulates that this strict proportionality criterion can be relaxed so the weight of Proprietary Directors is greater than would strictly correspond to the total percentage of capital they represent in large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.

In this regard, Telefónica ranks among the top listed companies on Spanish stock exchanges in terms of stock market capitalization, reaching the figure of 42,186 million euros at December 31, 2017, which means a very high absolute value of the stakes of "la Caixa" and BBVA in Telefónica (that of "la Caixa" is 2,112 million euros, and that of BBVA is 2,179 million euros). This justifies the overrepresentation of these entities on the Board of Directors, rising from one member of the Board each (to which they would strictly have the right in accordance with Article 243 of the Spanish Corporations Act) to two members, i.e. permitting the appointment of just one more Proprietary Director over the strictly legal proportion.

On January 23, 2011, China Unicom and Telefónica, S.A. expanded on their existing strategic alliance and signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. In recognition of China Unicom's stake in Telefónica, approval was given at Telefónica's General Shareholders' Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

17. Independent Directors should be at least half of all board members.

However, when the company does not have a large market capitalisation, or when a large cap company has shareholders individually or concertedly controlling over 30 percent of capital, independent Directors should occupy, at least, a third of board places.

Complies

18. Companies should disclose the following Director particulars on their websites and keep them regularly updated:

a) Background and professional experience.

b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.

c) Statement of the Director class to which they belong, in the case of proprietary Directors indicating the shareholder they represent or have links with.

d) Dates of their first appointment as a board member and subsequent re-elections.

e) Shares held in the company, and any options on the same.

Complies

19. Following verification by the Nomination Committee, the Annual Corporate Governance Report should disclose the reasons for the appointment of proprietary Directors at the urging of shareholders controlling less than 3 percent of capital; and explain any rejection of a formal request for a board place from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary Directorship.

Complies

20. Proprietary Directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary Directors, the latters' number should be reduced accordingly.

Complies

21. The Board of Directors should not propose the removal of independent Directors before the expiry of their tenure as mandated by the Bylaws, except where they find just cause, based on a proposal from the Nomination Committee. In particular, just cause will be presumed when Directors take up new posts or responsibilities that prevent them allocating sufficient time to the work of a board member, or are in breach of their fiduciary duties or come under one of the disqualifying grounds for classification as independent enumerated in the applicable legislation.

The removal of independent Directors may also be proposed when a takeover bid, merger or similar corporate transaction alters the company's capital structure, provided the changes in board membership ensue from the proportionality criterion set out in recommendation 16.

Complies

22. Companies should establish rules obliging Directors to disclose any circumstance that might harm the organisation's name or reputation, tendering their resignation as the case may be, and, in particular, to inform the Board of any criminal charges brought against them and the progress of any subsequent trial.

The moment a Director is indicted or tried for any of the offences stated in company legislation, the Board of Directors should open an investigation and, in light of the particular circumstances, decide whether or not he or she should be called on to resign. The Board should give a reasoned account of all such determinations in the Annual Corporate Governance Report.

Complies

23. Directors should express their clear opposition when they feel a proposal submitted for the Board's approval might damage the corporate interest. In particular, independents and other Directors not subject to potential conflicts of interest should strenuously challenge any decision that could harm the interests of shareholders lacking board representation.

When the Board makes material or reiterated decisions about which a Director has expressed serious reservations then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next recommendation.

The terms of this recommendation also apply to the secretary of the Board, even if he or she is not a Director.

Complies

24. Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the Board. Whether or not such resignation is disclosed as a material event, the motivating factors should be explained in the Annual Corporate Governance Report.

Complies

25. The Nomination Committee should ensure that Non-executive Directors have sufficient time available to discharge their responsibilities effectively.

The Board of Directors regulations should lay down the maximum number of company boards on which Directors can serve.

Complies

26. The Board should meet with the necessary frequency to properly perform its functions, eight times a year at least, in accordance with a calendar and agendas set at the start of the year, to which each Director may propose the addition of initially unscheduled items.

Complies

27. Director absences should be kept to a strict minimum and quantified in the Annual Corporate Governance Report. In the event of absence, Directors should delegate their powers of representation with the appropriate instructions.

Complies

28. When Directors or the secretary express concerns about some proposal or, in the case of Directors, about the company's performance, and such concerns are not resolved at the meeting, they should be recorded in the minute book if the person expressing them so requests.

Complies

29. The company should provide suitable channels for Directors to obtain the advice they need to carry out their duties, extending if necessary to external assistance at the company's expense.

Complies

30. Regardless of the knowledge Directors must possess to carry out their duties, they should also be offered refresher programmes when circumstances so advise.

Complies

31. The agendas of board meetings should clearly indicate on which points Directors must arrive at a decision, so they can study the matter beforehand or gather together the material they need.

For reasons of urgency, the Chairman may wish to present decisions or resolutions for board approval that were not on the meeting agenda. In such exceptional circumstances, their inclusion will require the express prior consent, duly minuted, of the majority of Directors present.

Complies

32. Directors should be regularly informed of movements in share ownership and of the views of major shareholders, investors and rating agencies on the company and its group.

Complies

33. The Chairman, as the person charged with the efficient functioning of the Board of Directors, in addition to the functions assigned by law and the company's bylaws, should prepare and submit to the Board a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the Board and, where appropriate, the company's chief executive officer; exercise leadership of the Board and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each Director, when circumstances so advise.

Complies

34. When a lead independent Director has been appointed, the Bylaws or Board of Directors regulations should grant him or her the following powers over and above those conferred by law: chair the Board of Directors in the absence of the Chairman and Vice-Chairman give voice to the concerns of Non-executive Directors; maintain contacts with investors and shareholders to hear their views and develop a balanced understanding of their concerns, especially those to do with the company's corporate governance; and coordinate the Chairman's succession plan.

Complies

35. The Board Secretary should strive to ensure that the Board's actions and decisions are informed by the governance recommendations of the Good Governance Code of relevance to the company.

Complies

36. The Board in full should conduct an annual evaluation, adopting, where necessary, an action plan to correct weakness detected in:

a) The quality and efficiency of the Board's operation.

b) The performance and membership of its Committees.

c) The diversity of board membership and competences.

d) The performance of the Chairman of the Board of Directors and the company's chief executive.

e) The performance and contribution of individual Directors, with particular attention to the chairmen of board committees.

The evaluation of board committees should start from the reports they send the Board of Directors, while that of the Board itself should start from the report of the nomination committee.

Every three years, the Board of Directors should engage an external facilitator to aid in the evaluation process. This facilitator's independence should be verified by the nomination committee.

Any business dealings that the facilitator or members of its corporate group maintain with the company or members of its corporate group should be detailed in the Annual Corporate Governance Report.

The process followed and areas evaluated should be detailed in the Annual Corporate Governance Report.

Complies

37. When an Executive Committee exists, its membership mix by Director class should resemble that of the Board. The Secretary of the Board should also act as secretary to the Executive Committee.

Complies

38. The Board of Directors should be kept fully informed of the business transacted and decisions made by the Executive Committee. To this end, all board members should receive a copy of the committee's minutes.

Complies

39. All members of the Audit Committee, particularly its Chairman, should be appointed with regard to their knowledge and experience in accounting, auditing and risk management matters. A majority of Committee places should be held by independent Directors.

Complies

40. Listed companies should have a unit in charge of the internal audit function, under the supervision of the Audit Committee, to monitor the effectiveness of reporting and control systems. This unit should report functionally to the Board's Non-executive Chairman or the Chairman of the Audit Committee.

Complies

41. The head of the unit handling internal audit function should present an annual work programme to the Audit Committee, inform it directly of any incidents arising during its implementation and submit an activities report at the end of each year.

Complies

42. The Audit Committee should have the following functions over and above those legally assigned:

1º With respect to internal control and reporting systems:

a) Monitor the preparation and the integrity of the financial information prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.

b) Ensure the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.

c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2º With regard to the external auditor:

a) Investigate the issues giving rise to the resignation of the external auditor, should this come about.

b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.

c) Ensure that the company notifies any change of external auditor to the CNMV as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.

d) Ensure that the external auditor has a yearly meeting with the Board in full to inform it of the work undertaken and developments in the company's risk and accounting positions.

e) Ensure that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.

Complies

43. The Audit Committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.

Complies

44. The Audit Committee should be informed of any fundamental changes or corporate transactions the company is planning, so the committee can analyse the operation and report to the Board beforehand on its economic conditions and accounting impact and, when applicable, the exchange ratio proposed.

Complies

45. Risk control and management policy should identify at least:

a) The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance sheet risks.

b) The determination of the risk level the company sees as acceptable.

c) The measures in place to mitigate the impact of identified risk events should they occur.

d) The internal control and reporting systems to be used to control and manage the above risks, including contingent liabilities and off-balance sheet risks.

Complies

46. Companies should establish a risk control and management function in the charge of one of the company's internal department or units and under the direct supervision of the Audit Committee or some other dedicated board committee. This function should be expressly charged with the following responsibilities:

a) Ensure that risk control and management systems are functioning correctly and, specifically, that major risks the company is exposed to are correctly identified, managed and quantified.

b) Participate actively in the preparation of risk strategies and in key decisions about their management.

c) Ensure that risk control and management systems are mitigating risks effectively in the frame of the policy drawn up by the Board of Directors.

Complies

47. Appointees to the Nomination and Remuneration Committee – or of the Nomination Committee and Remuneration Committee, if separately constituted – should have the right balance of knowledge, skills and experience for the functions they are called on to discharge. The majority of their members should be independent Directors.

Complies

48. Large cap companies should operate separately constituted Nomination and Remuneration Committees.

Explain

Article 40 of the Bylaws, and Article 23 of the Regulation of the Board of Directors, expressly state, on regulating the Nominating, Compensation and Corporate Governance Committees, that the Board of Directors shall be entitled to set up two Committees, separately giving each of them powers for appointments, and the other the powers for remuneration, while the corporate governance powers may be included in either one of them.

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. The Nomination Committee should consult with the company's Chairman and chief executive, especially on matters relating to Executive Directors.

When there are vacancies on the Board, any Director may approach the Nomination Committee to propose candidates that it might consider suitable.

Complies

50. The Remuneration Committee should operate independently and have the following functions in addition to those assigned by law:

a) Propose to the Board the standard conditions for senior officer contracts.

b) Monitor compliance with the remuneration policy set by the company.

c) Periodically review the remuneration policy for Directors and senior officers, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other Directors and senior officers in the company.

d) Ensure that conflicts of interest do not undermine the independence of any external advice the Committee engages.

e) Verify the information on Director and senior officers' pay contained in corporate documents, including the annual Directors' remuneration statement.

Complies

51. The Remuneration Committee should consult with the company's Chairman and chief executive, especially on matters relating to Executive Directors and senior officers.

Complies

52. The terms of reference of supervision and control committees should be set out in the Board of Directors regulations and aligned with those governing legally mandatory board committees as specified in the preceding sets of recommendations. They should include at least the following terms:

a) Committees should be formed exclusively by Non-executive Directors, with a majority of independents.

b) They should be chaired by independent Directors.

c) The Board should appoint the members of such committees with regard to the knowledge, skills and experience of its Directors and each committee's terms of reference; discuss their proposals and reports; and provide report-backs on their activities and work at the first board plenary following each committee meeting.

d) They may engage external advice, when they feel it necessary for the discharge of their functions.

e) Meeting proceedings should be minuted and a copy made available to all board members.

Explain

1. The supervision and control committees which are attributed the powers referred to in recommendation 52 are the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee. The composition and operation rules of the two Committees are set out in the Regulation of the Board of Directors (and, 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 five members of this committee are all independent.

2. The Board of Directors has other Consultative Committees which are allocated other functions (Regulation and Institutional Affairs Committee, Service Quality and Customer Service Committee, 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 as those which are legally mandatory.

In particular, it has been decided that Committees with powers in matters linked to the Company's businesses and management aspects do not necessarily have to be chaired by independent Directors nor do most of the members of the committees need to have independent directors, but that it is preferable to take into account the technical knowledge and specific expertise of their members when appointing the Director to chair them and the other Directors who should sit on these committees.

53. The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one board committee or split between several, which could be the Audit Committee, the Nomination Committee, the Corporate social responsibility Committee, where one exists, or a dedicated committee established ad hoc by the Board under its powers of self-organisation, with at the least the following functions:

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

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

c) Periodically evaluate the effectiveness of the company's corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.

d) Review the company's corporate social responsibility policy, ensuring that it is geared to value creation.

e) Monitor corporate social responsibility strategy and practices and assess compliance in their respect.

f) Monitor and evaluate the company's interaction with its stakeholder groups.

g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.

h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

Complies

54. The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:

a) The goals of its corporate social responsibility policy and the support instruments to be deployed.

b) The corporate strategy with regard to sustainability, the environment and social issues.

c) Concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.

d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.

e) The mechanisms for supervising non-financial risk, ethics and business conduct.

f) Channels for stakeholder communication, participation and dialogue.

g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

Complies

55. The company should report on corporate social responsibility developments in its Directors' report or in a separate document, using an internationally accepted methodology.

Complies

56. Director's remuneration should be sufficient to attract individuals with the desired profile and compensate the commitment, abilities and responsibility that the post demands, but not so high as to compromise the independent judgement of Non-executive Directors.

Complies

57. Variable remuneration linked to the company and the Director's performance, the award of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements, and membership of long-term savings schemes such as pension plans should be confined to Executive Directors.

The company may consider the share-based remuneration of Non-executive Directors provided they retain such shares until the end of their mandate. This condition, however, will not apply to shares that the Director must dispose of to defray costs related to their acquisition.

Complies

58. In the case of variable awards, remuneration policies should include limits and technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, or circumstances of that kind.

In particular, variable remuneration items should meet the following conditions:

a) Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.

b) Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.

c) Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards ongoing achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.

Complies

59. A major part of variable remuneration components should be deferred for a long enough period to ensure that predetermined performance criteria have effectively been met.

Complies

60. Remuneration linked to company earnings should bear in mind any qualifications stated in the external auditor's report that reduce their amount.

Not applicable

61. A major part of Executive Directors' variable remuneration should be linked to the award of shares or financial instruments whose value is linked to the share price.

Complies

62. Following the award of shares, share options or other rights on shares derived from the remuneration system, Directors should not be allowed to transfer a number of shares equivalent to twice their

annual fixed remuneration, or to exercise the share options or other rights on shares for at least three years after their award.

The above condition will not apply to any shares that the Director must dispose of to defray costs related to their acquisition.

Explain

On December 31, 2017, 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 valuated with a price of 8.13 euros per share, represented 572% 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 333,463 ting rights, which were valuated with a price of 8.13 euros per share, represented 226% 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.

63. Contractual arrangements should include provisions that permit the company to reclaim variable components of remuneration when payment was out of step with the Director's actual performance or based on data subsequently found to be misstated.

Partially complies

The Nominating, Compensation and Corporate Governance Committee is empowered to propose that the Board of Directors cancels a variable remuneration payment in the event of circumstances such as those described in this recommendation. The Nominating, Compensation and Corporate Governance Committee will also assess if exceptional circumstances of this kind may even entail the termination of the relationship with the person responsible, proposing measures which are deemed pertinent to the Board of Directors.

64. Termination payments should not exceed a fixed amount equivalent to two years of the Director's total annual remuneration and should not be paid until the company confirms that he or she has met the predetermined performance criteria.

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, mantain 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. 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.

H. Other information of interest

1. **If you consider that there is any material aspect or principle relating to the corporate governance practices followed by your company that has not been addressed in this report and which is necessary to provide a more comprehensive view of the corporate governance structure and practices at the company or group, explain briefly.**

   --

2. **You may include in this Section any other information, clarification or observation related to the above sections of this report, provided that they are relevant and non-reiterative.**

   Specifically indicate whether the company is subject to corporate governance legislation from a country other than Spain and, if so, include the compulsory information to be provided when different to that required by this report.

3. **The company may also state whether it voluntarily subscribes to other international, sectorial or other ethical principles or standard practices. If applicable, identify the name of the code and the date of subscription.**

GENERAL CLARIFICATION: It is hereby stated that the details contained in this report refer to the financial year ended on December 31, 2017, except in those issues in which a different date of reference is specifically mentioned.

- Note 1 to Section A.2.]

On January 30, 2018, BlackRock, Inc. informed to the Securities Exchange Commission that, at December 31, 2017, its shareholding on the share capital of Telefónica, S.A. was 6.63%.

On December 18, 2017, BlackRock, Inc. informed to the Spanish National Securities Market Commission (CNMV) that, at December 14, 2017, its shareholding on the share capital of Telefónica, S.A. was 5.04%.

Likewise, and in accordance with the submitted communication by BlackRock, Inc. to the Spanish National Securities Market Commission (CNMV) on May 9, 2017, May 16, 2017, June 5, 2017, June 23, 2017, December 1, 2017, and December 18, 2017, 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 Cayco Limited, BlackRock Trident Holding Company Limited, 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 Group 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 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 Group 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 Group 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 Group Limited, BlackRock (Netherlands) B.V.

- Note 2 to Section A.3.]

On January 5, 2018, Telefónica, S.A. notified the Spanish National Securities Market Commission of the acquisition, on behalf of Board Member Mr. José María Abril Pérez, of 38,984 direct shares, and 33,965 indirect shares. Currently, on the registered date of this Report, Board Member Mr. José María Abril Pérez has a total of 388,237 shares, 196,061 of which are direct and 192,176 of which are indirect.

On January 17, 2018, Telefónica, S.A. notified the Spanish National Securities Market Commission of the acquisition of 2,500,000 indirect shares, on behalf of Board Member Mr. Francisco José Riberas Mera. Currently, on the registered date of this report, Board Member Mr. Francisco José Riberas Mera has a total of 2,549,173 indirect shares.

- Note 3 to Section A.3.]

It should be noted that the Company has an Internal Code of Conduct for Securities Markets Issues setting out, among other issues, the general operating principles for Directors and senior executives when carrying out personal trades involving securities issued by Telefónica, S.A. and financial instruments and contracts whose underlying securities or instruments are issued by the Company. The Board of Directors on its meeting held on December 14, 2016, approved a new version of the Internal Code of Conduct in order to adapt it to the regulatory changes on this matter.

The general operating principles of this Internal Code of Conduct include transactions subject to notification, action limitations as well as the minimum holding period when acquiring securities in the Company, during which time these may not be transferred, except in the event of extraordinary situations that justify their transfer, subject to authorisation by the Regulatory Compliance Committee.

- Note 4 to Section A.3.]

The General Shareholders' Meeting on May 30, 2014, shareholders approved the introduction of a long-term incentive plan for managers of the Group (including Executive Directors), also known as the Performance & Investment Plan ("PIP"). Under this plan, participants who met the qualifying requirements were also awarded a certain number of Telefónica, S.A. shares as a form of variable remuneration. This General Shareholders' Meeting approved the maximum number of shares to be awarded to Executive Directors subject to their meeting the co-investment requirement established in the Plan and the maximum target total shareholder return (TSR) established for each phase.

In accordance with the above, the amounts appearing in Section A.3. of this report under "Number of direct votes" and "Equivalent number of shares" (i.e. Mr. José María Álvarez-Pallete López, 192,000-300,000 and Mr. Ángel Vilá Boix, 120,000-187,500) relate to the theoretical number of shares assigned and the maximum possible number of shares in the Second Phase of the Plan approved by the General Shareholders Meeting of 30 May 2014, if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met.

The first cycle of this Plan started in 2014 and ended in October 2017. In accordance with that established in the general conditions, the delivery of shares from the first cycle of the Plan did not occur (2014-2017), which is why no shares were delivered to the Executive Board Members who participated in it.

The second cycle of this Plan started in 2015 and will end in October 2018.

Regarding the third phase of this Plan (2016-2019), the Board of Directors of the Company, after a favourable report from the Nominating, Compensation and Corporate Governance Committee, agreed not to execute nor implement, it due to it was not aligned enough with the strategic plan of Group Telefónica, considering the circumstances and the macroeconomic environment.

- Note 5 to Section A.6.]

Shareholder Pact between Telefónica, S.A. – Vivendi, S.A.

In September 2015, after the regulatory approval from Conselho Administrativo de Defesa Econômica (CADE), Telefónica, S.A. delivered to Vivendi, S.A. 46.0 million of its treasury shares representing, in that moment, 0.95% of its share capital, in exchange for 58.4 million preference shares of Telefónica Brasil, S.A. (received by Vivendi, S.A. as part of the acquisition of GVT Participaçoes, S.A.), accounting for approximately 3.5% of the share capital of Telefónica Brasil, S.A.

By virtue of this agreement, Vivendi, S.A. agreed to a number of obligations, including the following: (i) to refrain from selling shares of Telefónica during certain periods (lock up), and (ii) accept certain restrictions which, in the event of transfer, once the lock up periods have elapsed, guarantee that such shares are sold in an orderly manner.

As of 31 December 2017, the shareholding of Vivendi on the share capital of Telefónica, S.A. was 0.95%.

Shareholder Pact between Telefónica, S.A. - China Unicom (Hong Kong) Limited

In accordance with the provisions of Article 112, Section 2 of the Securities Market Act 24/1988, of July 28 (currently replaced by Article 531 Section 1 of the revised text of the Spanish Corporations Act approved by Royal Decree Law 1/2010, of July 2), on October 22, 2009, the Company notified the Spanish Securities Market Commission (Comisión Nacional del Mercado de Valores, "CNMV") that on September 6, 2009 Telefónica had entered into a mutual share exchange agreement with China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 were considered a shareholder agreement as per Article 530 of the Spanish Corporations Act. By virtue of these clauses, Telefónica undertook not to, while the strategic partnership agreement was in force, offer, issue or sell a significant number of its shares or any convertible security or security that conferred the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited. In addition, China Unicom (Hong Kong) Limited undertook not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica's voting share capital (excluding intragroup transfers). This undertaking expired when the aforementioned period of one year had elapsed. At the same time, both parties also undertook similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited. This mutual share exchange agreement, which includes the shareholder agreement, was filed with the Madrid Mercantile Registry on November 24, 2009. The aforementioned undertakings are no longer in force.

On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited signed an agreement to enhance their strategic partnership, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Through its subsidiary Telefónica Internacional, S.A.U., Telefónica acquired a number of China Unicom shares amounting to 500 million US dollars from third parties, within nine months of signature of this agreement. In recognition of China Unicom's stake in Telefónica, the latter commits to proposing the appointment of a board member nominated by China Unicom in the next General Shareholders' Meeting, in accordance with prevailing legislation and the Company's By-laws.

China Unicom completed the acquisition of Telefónica shares on January 28, 2011, giving it ownership of 1.37% of the Company’s capital.

The Telefónica Group purchased China Unicom shares during 2011 to the amount of 358 million euros. At December 31, 2011, the Telefónica Group held a 9.57% stake in the company.

On June 10, 2012, Telefónica, S.A. through its wholly-owned subsidiary Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited, through a wholly-owned subsidiary, signed an agreement for the purchase by the latter of 1,073,777,121 shares in China Unicom (Hong Kong) Limited owned by Telefónica, equivalent to 4.56% of its capital.

After securing the requisite regulatory authorizations, the sales transaction was completed on July 30, 2012.

Subsequent to the transaction, Telefónica and China Unicom remained firmly committed to their strategic partnership.

Telefónica agreed not to sell the shares it holds directly and indirectly in China Unicom for a period of 12 months as from the date of the agreement.

On November 10, 2014 Telefónica sold 597,844,100 shares in China Unicom, representing 2.5% of the capital of the latter, in a block trade process, at a price of HK $ 11.14 per share, in a total amount of HK $ 6,660 million, approximately 687 million euros at exchange rates on that date.

Telefónica undertook not to sell any shares held directly or indirectly in China Unicom on the market for a period of 12 months from the selling date.

Likewise, on July 13, 2016, Telefónica through its 100% subsidiary, Telefónica Internacional, S.A.U. proceeded with the sale of 361,794,559 shares of China Unicom, representing 1.51% of the share capital of the company, by a block trade process, at a price of HK $ 7.80 per share, for a total amount of HK $ 2,822 million, approximately € 322 million,

Telefónica committed not to transfer to the market the shares of China Unicom, which it may own directly or indirectly, over a period of 90 days from the sales date.

As of December 31, 2017 Telefónica held a shareholding of 0.59% in the share capital of China Unicom and China Unicom held a shareholding of 1.24% in the share capital of Telefónica. Mr. César Alierta, former chairman of Telefónica, is a member of the Board of Directors of China Unicom while Mr. Wang Xiaochu, Chairman and Chief Executive Officer of China Unicom, is currently a board member of Telefónica.

Telefónica maintains its commitment to the strategic partnership with China Unicom, strengthened through cooperation in digital areas such as the big data joint venture between both companies, which is now a market leader of telco location based big data services in the urban planning sector in China.

Shareholders’ Agreement Telefónica, S.A. - Koninklijke KPN NV

On March 13, 2017, Telefónica, S.A. ("Telefónica") entered into a swap agreement with Koninklijke KPN NV ("KPN") by virtue of which Telefónica delivered 72.0 million of its treasury shares (representing 1.43% of its share capital), in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter.

As a result of this agreement, Telefónica increased from 63.2% to 69.2% its shareholding in Telefonica Deutschland Holding AG.

By virtue of said agreement, KPN undertook, among other obligations, to comply with certain restrictions which, in case of sale of the aforementioned Telefónica shares, would ensure an orderly sale of such shares.

Such shareholder agreement is no longer in force.

- Note 6 to Section A.9.bis]

As stated in Section A.6 of this report, in September 2015, after the regulatory approval from Conselho Administrativo de Defesa Econômica (CADE), Telefónica, S.A. delivered to Vivendi 46.0 million of its treasury shares, representing, in that moment, 0.95% of its share capital, in exchange for 58.4 million preference shares of Telefónica Brasil, S.A. (received by Vivendi, S.A. as part of the acquisition of GVT Participaçoes, S.A.), accounting for approximately 3.5% of the share capital of Telefónica Brasil, S.A.

By virtue of this agreement, Vivendi, S.A. agreed to a number of obligations, including the following: (i) refrain from selling shares of Telefónica during certain periods (lock up), and (ii) accept certain restrictions which, in the event of transfer, once the lock up periods have elapsed, guarantee that such shares are sold in an orderly manner.

As of December 31, 2017, the shareholding of Vivendi on the share capital of Telefónica, S.A. was 0.95%.

Therefore, the aforementioned percentage of 0.95% of share capital has not been included in the percentage of "estimated free-float capital" set out in section A.9.bis of this Report.

- Note 7 to Section A.10.]

In accordance with Article 26 of the Corporate By-laws, no shareholder may cast a number of votes in excess of 10% of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10% voting ceiling.

The limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

For the purposes of the provisions contained in the preceding paragraph, the provisions of Section 18 of the current Spanish Corporations Act shall apply in order to decide whether or not a group of entities exists and to examine the situations of control indicated above.

In relation to the above and in accordance with the provisions of Article 527 of the Spanish Corporations Act, any clauses in the By-laws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

- Note 8 to Section C.1.2.]

On January 31, 2018, the Board of Directors, unanimously appointed by co-optation, and at the recommendation of the Nominating, Compensation and Corporate Governance Committee, Mr. Jordi Gual Solé as a Telefónica Board Member, with the condition of Proprietary Director (at the proposal of CaixaBank, S.A.), replacing Mr. Antonio Massanell Lavilla, who had voluntary resigned from his position as Board Member of the Company on December 21, 2017. Likewise, the Board of Directors agreed to appointment Mr. Jordi Gual Solé as member of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee.

- Note 9 to Section C.1.5.]

The search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to co-opt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. Eva Castillo Sanz as a Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders Meeting held on April 22, 2008, and she was re-elected to serve in this position by the Ordinary General Shareholders' Meeting on May 31, 2013.

Likewise, on April 8, 2016, the Board of Directors unanimously agreed to co-opt, at the proposal Nominating, Compensation and Corporate Governance Committee, Ms. Sabina Fluxà Thienemann as a Director of Telefónica. The Ordinary General Shareholders Meeting, held on May 12, 2016, ratified this appointment.

Additionally, on May 4, 2017, the Board of Directors unanimously appointed by co-optation, and at the recommendation of the Nomination, Compensation and Corporate Governance Committee, Ms. Carmen García de Andrés as Telefónica Board Member. This appointment was ratified by the General Shareholder's Meeting held on June 9, 2017.

Similarly, on December 19, 2007, the Board of Directors unanimously agreed, following a recommendation from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary to the Board of Directors.

Article 10.3. of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of 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.

Article 10.4 of the Regulations of the Board of Directors also provides that the Board will have to ensure that Board members are selected using procedures that guarantee gender equality and diversity of knowledge and experience, that prevent any underlying bias which could cause any kind of discrimination, and, in particular, that the procedures should favor the selection of female directors.

With respect to this appointment, the Board of Directors approved, at its meeting on November 25, 2015, a Board Member Selection Policy, that has been updated on December 13, 2017, by agreement of the Board of Directors, which includes 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 Board Member Selection, which includes the latest regulatory demands regarding diversity. The purpose of this Policy is to ensure that the proposals for appointment and re-election are based on a prior analysis of the Board's needs, and that they favor the diversity of knowledge, education and professional experience, age, and gender, but without implicit biases that could entail any discrimination, particularly based on gender, disability, or any other personal condition.

The 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.

In accordance with the aforesaid Policy, candidates to be Telefónica Directors will be selected using the following principles:

1.- The Company will ensure that the Board of Directors has a balanced structure, with an ample majority of non-executive Directors and an adequate proportion between Proprietary and Independent Directors.

2. The Board of Directors shall ensure that the selection procedures for Board Members favor the diversity of knowledge, education, professional experience, age, and gender, without implicit biases that could entail any discrimination. This is all done in order to ensure that the Board of Directors has a diverse and balanced composition in their group, which i) enriches the analysis and debate, ii) includes several points of view and positions, iii) favors the making of decisions, and iv) benefits from full independence.

It will also ensure that candidates put forward to be non-executive Directors have enough time available to be able to adequately perform their duties.

3.- A preliminary analysis of the Company's and of the Group's requirements will be used in the process of selecting candidates to be Directors. This analysis will be made by the Company's Board of Directors, which will be advised and which will receive a mandatory preliminary report by the Nominating, Compensation and Corporate Governance Committee.

4.- This report by the Nominating, Compensation and Corporate Governance Committee will be published when calling the General Shareholders Meeting at which each Director will be submitted for confirmation, appointment or re-election.

5. The Nominating, Compensation and Corporate Governance Committee shall annually verify compliance with the Diversity Policy with respect to the Telefónica, S.A. Board of Directors and Board Member Selection, and shall disclose this in the Annual Corporate Governance Report and any other documents deemed appropriate.

Likewise, and with respect to the Board Member candidates, the Diversity Policy related to the Telefónica, S.A. Board of Directors and Board Member Selection, it establishes that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee will ensure, within the scope of their respective powers, that the election of a candidate for the position of Board Member will fall to people with recognized solvency, competence and experience, and who are available to dedicate the necessary time and effort to perform their duties, taking extreme care when selecting those people called upon to fill in the positions of Independent Board Members.

Therefore, the Board candidates shall be people with recognized prestige, solvency, education and professional experience, especially in telecommunications, financial and economic management, accounting, auditing, risk management, and/or company administration, experience leading teams made up of people belonging to different areas of business and extensive experience at large companies.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates (“recognised calibre, qualifications and experience”) and their ability to dedicate themselves to the functions of members of the Board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.

- Note 10 to Section C.1.11.]

On September 4, 2017, Mr. Ángel Vilá Boix presented his resignation as Board Member of Telefónica Brasil, S.A. Likewise, on October 4, 2017, Mr. Ángel Vilá Boix presented his resignation as Member of the Supervisory Board of Telefónica Deutschland Holding, AG.

- Note 11 to Section C.1.12.]

According to the Significant Event registered by Gas Natural SDG, S.A. on February 6, 2018, Mr. Isidro Fainé Casas presented his resignation as Member of Gas Natural SDG,S.A., being named as Honorary Chairman.

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

- Note 12 to Section C.1.16.]

For these purposes, Senior Executives are understood to be individuals who perform senior management functions reporting directly to the management bodies, or their Executive Commissions or CEOs. For the purposes of annual remuneration, the head of Internal Audit is also included.

Ms. Laura Abasolo García de Baquedano was appointed Chief Finance and Control Officer, replacing the current Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix on July 26, 2017, in light of the remuneration received up to this date by Mr. Ángel Vilá Boix, and that received since this date by Ms. Laura Abasolo García de Baquedano.

- Note 13 to Section C.1.16. and C.1.33]

On January 31, 2018, Mr. Pablo de Carvajal González was appointed Secretary of the Board of Directors and Director of Public Affairs and Regulation, replacing Mr. Ramiro Sánchez de Lerín García-Ovies.

- Note 14 to Section C.1.17]

Ms. Sabina Fluxà Thienemann is member of the Regional Advisory Board of the East (joining Valencia, Murcia and Baleares) of Banco Bilbao Vizcaya Argentaria, S.A., to whom she advices 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.

- Note 15 to Section C.1.19.]

Selection and appointment

Telefónica's Bylaws state that the Board of Directors shall be composed of a minimum of five members and a maximum of twenty, to be appointed at the General Shareholders Meeting. Directors are appointed for a period of no longer than four years, and may be re-elected for one or more subsequent periods of no longer than four years at a time. The Board of Directors may, in accordance with the Spanish Corporations Act and the Company Bylaws, provisionally co-opt Directors to fill any vacancies.

The Board of Directors shall have the power to fill, on an interim basis, any vacancies that may occur therein, by appointing, in such manner as is legally allowed, the persons who are to fill such vacancies until the holding of the next General Shareholders Meeting.

Also, in all cases, proposed appointments of Directors must follow the procedures set out in the Company's Bylaws and Regulations of the Board of Directors and be preceded by the appropriate favourable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the Committee. Proposals for individuals to represent legal entities (companies) have to be made following a report by the Nominating, Compensation and Corporate Governance Committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must assess the skills, knowledge and experience required in the Board of Directors, defining the functions and abilities needed by candidates to cover each vacancy,and evaluating the time and dedication needed for them to efficiently perform their duties. It will also have to escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposed appointments of other Company Directors to the Board of Directors for appointment by co-option or for the design to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.

In line with the provisions of its Regulations, the Board of Directors, exercising the right to fill vacancies by interim appointment and to propose appointments to the shareholders at the General Shareholders Meeting, shall ensure that, in the composition of the Board of Directors, external or non-executive Directors represent an ample majority over executive Directors. Similarly, the Board shall ensure that the total number of independent Directors represents at least one third of the total number of Board members.

The nature of each Director shall be explained by the Board of Directors to the shareholders at the General Shareholders Meeting at which the appointment thereof must be made or ratified. Furthermore, such nature shall be reviewed annually by the Board after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

In any event, and in the event of re-election or ratification of Directors by the General Shareholders Meeting, the report of the Nominating, Compensation and Corporate Governance Committee, or, in the case of independent Directors, the proposal of said Committee, will contain an assessment of the work and effective time devoted to the post during the last period in which it was held by the proposed Director.

Both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that those proposed for the post of Director should be persons of recognised calibre, qualifications and experience, who are willing to devote the time and effort necessary to carrying out their functions, and shall take extreme care in the selection of persons to be appointed as independent Directors.

The Board of Directors will have to ensure that Board members are selected using procedures that guarantee gender equality and diversity of knowledge and experience, that prevent any underlying bias would could cause any kind of discrimination, and, in particular, that the procedures should favour the selection of female directors.

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 organise and coordinate, together with the Chairman of the Board of Directors, the regular assessment of said body, after which the Board of Directors approves the assessment of its function and the functioning of its Committees.

In accordance with the above, it should be noted that the Board of Directors and its Committees carry out a periodic evaluation of the operation of the Board of Directors and of the Committees thereof in order to determine the opinion of Directors regarding the workings of these bodies and to establish any proposals for improvements to ensure the optimum working of the company's governing bodies.

Removal and dismissal

Directors' shall cease to hold office when the term for which they were appointed expires, or when so resolved by the shareholders at the General Shareholders Meeting in the exercise of the powers legally granted to them.

Directors who give up their place before their tenure expires, should state their reasons in a letter to be sent to all members of the Board of Directors.

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board alter a report from the Nominating, Compensation and Corporate Governance Committee. Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

The removal of independent Directors may also be proposed as a result of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

- Note 16 to Section C.1.31]

In accordance with US securities market regulations, the information contained in the Annual Report in 20-F format (which includes the Consolidated Financial Statements of the Telefónica Group), filed with the Securities and Exchange Commission, is certified by the Executive Chairman of the Company and by the CFO. This certification is made after the Financial Statements have been prepared by the Board of Directors of the Company.

- Note 17 to Section C.1.36.]

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.

- Note 18 to Section C.1.39.]

Financial year 1983 was the first audited by an External Auditor. Previously the financial statement were revised by chartered accountants (known at the time as "censores de cuentas"). Therefore, 1983 is the base year taken for calculating the percentage in the case of audits of the Financial Statements of Telefónica, S.A., while 1991 is the date taken for the calculation of the percentage in the case of the Consolidated Financial Statements, as 1991 was the first year in which the Telefónica Group prepared Consolidated Financial Statements.

- Note 19 to Section C.2.1]

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 materialise; and

c) the control and information systems to be used to control and manage these risks.

6) Establish and supervise a system that allows employees to confidentially and anonymously report potentially significant irregularities, particularly any financial and accounting irregularities detected within the Company.

7) Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, and, when applicable, the authorisation of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualised information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.

8) Issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in point 7) above, considered individual and in their entirety, other than legal audit, and in relation to the regime of independence or laws regulating auditing activities.

9) Analyse and report on economic conditions, the accounting impact, and, if applicable, the proposed exchange ratio in structural and corporative modification transactions which the Company intends to perform, before being submitted to the Board of Directors.

10) Preliminary reporting to the Board of Directors regarding all matters set out in prevailing legislation and in the Bylaws, and, in particular, concerning:

1. The financial information that the Company must periodically disclose;

2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and

3. Related party transactions.

11) Exercise all the pertinent functions of the Audit Committee established at any given time by prevailing laws in regard to Group companies which are considered to be Public Interest Entities (as these are defined in applicable laws), provided that they are fully owned, either directly or indirectly, by the Company pursuant to applicable laws, and whose administration is not attributed to a Board of Directors.

The dispositions of sections 2, 7 and 8 are understood to be without prejudice to general auditing regulations.

c) Operation.

The Audit and Control Committee 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.

The main activities and actions carried out by the Audit and Control Committee of the Telefónica, S.A. Board of Directors throughout 2017 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 2016, 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 to what is established by Royal Decree 18/2017 of 24 November which modifies the Code of Commerce, the consolidated text of the Corporate Enterprises Act, and the Accounts Auditing Act in terms of non-financial and diversity information.

- Regarding the external auditor: i) proposal of fees to be received by PwC as the Account Auditor for 2017; 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) proposal to the Board of Directors of the regulations of the Audit and Control Committee; ii) revision of the works performed by Internal Auditing regarding the revision of transversal processes, investigations and inspections; and iii) revision of the risk management system.

- Regarding compliance, revision on regulatory compliance, including anti-corruption standards.

- Other relevant issues: i) 2016 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; iv) drafting of the Welcome Program for new members of the Telefónica, S.A. Audit and Control Committee; and v) periodic training to ensure the Committee members are updated on information.

Furthermore, regarding to the Director member of the Audit and Control Committee who has been appointed based on his knowledges and experience in accounting, audit or both, apart form Mr. José Javier Echenique Landiríbar, the Director Mr. Ignacio Moreno Martínez.

- Note 20 to Section C.2.1.]

Pursuant to the provisions of Article 40 of the Corporate Bylaws of Telefónica, S.A., Article 23 of the Regulations of the Board of Directors of the Company regulates the Nominating, Compensation and Corporate Governance Committee in the following terms:

a) Composition.

The Nominating, Compensation and Corporate Governance Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors, and most of them must be at least Independent Directors.

The Chairman of the Nominating, Compensation and Corporate Governance Committee, who shall in all events be an Independent Director, shall be appointed from among its members.

b) Duties.

Notwithstanding other duties entrusted it by the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall have the following duties:

1) Assess the skills, knowledge and experience necessary in the Board of Directors. For these purposes, it will define the roles and capabilities required of the candidates to fill each vacancy, and assess the time and dedication necessary for them to efficiently perform their duties.

2) Set a target of representation for the least represented gender on the Board of Directors and provide guidelines about how this target might be reached.

3) Escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.

4) Submit proposed appointments of other Company Directors to the Board of Directors for appointment by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposals for appointments or termination of the Secretary, and, if applicable, of the Deputy Secretary of the Board of Directors, and also proposals for the appointment, re-election and termination of Directors in their subsidiary companies.

5) Report on proposals to appoint or to terminate the Senior Management of the Company and their subsidiaries.

6) To report on the proposals for appointment of the members of the Executive Commission and of the other Committees of the Board of Directors, as well as the respective Secretary and, if applicable, the respective Deputy Secretary.

7) To propose to the Board of Directors the appointment of the Lead Director from among the Independent Directors.

8) To organise and coordinate, together with the Chairman of the Board of Directors, a periodic assessment of the Board, pursuant to the provisions of these Regulations.

9) To inform on the periodic assessment of the performance of the Chairman of the Board of Directors.

10) To examine or organize the succession of the Chairman of the Board of Directors and, if applicable, to make proposals to the Board of Directors so that such succession occurs in an orderly and well-planned manner.

11) To propose to the Board of Directors, within the framework established in the Corporate Bylaws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 34 of the Regulations of the Board.

12) To propose to the Board of Directors, within the framework established in the Bylaws, the extent and amount of the compensation, rights and remuneration of a financial nature of the Chairman of the Board of Directors, the Executive Directors and the senior executives of the Company, as well as the basic terms of their contracts, for purposes of contractual implementation thereof.

13) To prepare and propose to the Board of Directors an annual report regarding the Directors' compensation policy.

14) To verify information on the remuneration of Directors and senior management contained in the various corporate documents, including the annual report on Directors' remuneration.

15) To supervise compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.

16) To exercise other powers assigned to the Nominating, Compensation and Corporate Governance Committee in this Regulation.

c) Operation.

In addition to the meetings provided for in the annual schedule, the Nominating, Compensation and Corporate Governance Committee shall meet whenever the Board of Directors of the Company or the Chairman of the Board of Directors requests the issuance of a report or the making of a proposal within the scope of its powers and duties, provided that, in the opinion of the Chairman of the Committee, it is appropriate for the proper implementation of its duties.

The Nominating, Compensation and Corporate Governance Committee will consult with the Chairman of the Board of Directors particularly when concerning matters relating to executive directors and senior officers.

Most important actions during the year.

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 2017 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 Appointments, Remuneration and Good 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).

- 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 2017, 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.

  Therefore, at its meeting held on May 3, 2017, the Committee proposed the appointment by co-optation of Ms. Carmen García de Andrés and Mr. Francisco José Riberas Mera as Independent Board Members, after the voluntary resignation from their positions as Board Members, presented by Mr. César Alierta Izuel, Mr. Gonzalo Hinojosa Fernández de Angulo and Mr. Pablo Isla Álvarez de Tejera.

  Likewise, the Committee, at the aforementioned meeting on May 3, 2017, proposed the appointment of Independent Board Member Mrs. Carmen García de Andrés as Member of the Company Audit and Control Committee, as well as the appointment of Independent Board

Members Mr. José Javier Echenique Landiríbar and Mr. Luiz Fernando Furlán as Members of the Appointments, Remuneration and Good Governance 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 9, 2017, 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.

As such, the aforementioned General Shareholder's Meeting approved the re-election of Mr. José María Álvarez-Pallete López and Mr. Ignacio Moreno Martínez, as well as the ratification of the appointment of Mrs. Carmen García de Andrés and Mr. Francisco José Riberas Mera.

However, at its meeting held on July 25, 2017, the Committee favorably reported the appointment by co-optation of Mr. Ángel Vilá Boix as Executive Board Member, replacing Mr. Julio Linares López. Likewise, at the aforementioned meeting, the Committee favorably reported the proposal for the appointment of Mr. Ángel Vilá Boix as Chief Operating Officer and Member of the Executive Committee.

Likewise, at its meeting held on July 25, 2017, the Committee proposed the appointment of Independent Board Member Mrs. Carmen García de Andrés as Member of the Service Quality and Customer Service Committee of the Company.

Additionally, throughout the meetings held, the Committee has reported different proposals for the appointment of Board Members at the most relevant 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 2016 Remuneration Report.

- Note 21 to Section C.2.1.]

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 significant actions during the year.

In the 5 meetings held by the Service Quality and Customer Service Committee in 2017, 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 22 to Section C. 2.2.]

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.

Most significant actions during the year.

The Regulation and Institutional Affairs Committee held 11 meetings in the 2017 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, Integrated Annual Report, and actions of the Advisory Panel on Responsible Business created in the Telefónica Group.

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 23 to Section C. 2.2.]

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 significant actions during the year.

The Strategy and Innovation Committee held 11 meetings in the 2017 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 24 to Section D. 2.]

It is important to note that:

Transactions included in this section under ´Other´, amounting to 11,371 with BBVA, S.A. refer to Dividends received.

Transactions included in this section under ´Other´, for the sum of 6,525 with BBVA, S.A. refer to Other Revenues (99), to Other Expenses (6,418) and to Gains from derecognition or disposal of assets (8).

Transactions included in this section under ´Other´, for the sum of 250,012 with la "Caixa Group", refer to Other Expenses (12) and Outstanding factoring operations (250,000)

In addition, the nominal value of outstanding derivatives held with BBVA and la Caixa in 2017 amounted to 21,749 and 404 million euros, respectively. As explained in Derivatives policy in Note 16 of the 2017 Consolidated Annual Accounts, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying. The fair value of these same derivatives in the statement of financial position is 390 and -28 million euros, respectively, at December 31, 2017. Additionally, at December 31, 2017 there were collateral guarantees on derivatives with BBVA amounting to 286 million euros.

- Note 25 to Section D.5.]

On December 18, 2015, a joint venture was set up between China Unicom for the development of Big Data services in China, using Smart Steps technology developed by Telefónica. Telefónica has a stake of 45% through Telefónica Digital España, S.L.; China Unicom Broadband Online Limited Corp. owns the remaining 55%. In 2016, Telefónica disbursed 7 million euros corresponding to its shareholding in the capital of the company. The company is already commercially operational and obtained a turnover of 8 million euros in 2017.

According to Related Parties in Note 10 of the 2017 Consolidated Annual Accounts of Telefónica, S.A., certain Telefónica Group subsidiaries performed in 2017 transactions with Global Dominion Access Group, related to the Group´s ordinary course of business, mainly in Telefónica de España, amounting to 23 million euros.

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 21, 2018.

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

No

Name or corporate name of director	Reasons (voted against, abstention, non-attendance)	Explain the reasons
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APPENDIX TO THE TELEFÓNICA, S.A. 2017 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 the Company which could affect its business, financial position, reputation, corporate image and brand and its results of operations, must be considered jointly with the information in the Annual Financial Statements, and are as follows:

Group-Related Risks

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

Telefónica's international presence enables the diversification of its activities across countries and regions, but it exposes Telefónica to 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 the Company'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.

Macroeconomic perspectives in Europe have improved as two major risks have diminished during 2017. First, political uncertainty has decreased after the results of the general elections in some European countries and, second, the agreement reached in relation to the Greek bailout program and better macroeconomic data in the country have opened the door to a potential solution to the Greek debt crisis in the near term. While such risks have diminished, economic activity and financial stability in Europe could be affected by the monetary normalization that the European Central Bank is expected to continue implementing in the near future, with a negative impact on the balance between the private and public sectors, and by the restructuring processes which the European banking sector is still immersed in. Furthermore, the planned exit of the United Kingdom from the European Union following the outcome of the referendum held in 2016, will 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. In the meantime, there is uncertainty regarding investment, economic activity, employment and financial market volatility. Finally, another possible source of uncertainty given Telefónica's exposure, could come from Catalonia's political situation and its impact on the Spanish economy. Although recent events point to a lower degree of uncertainty, if political tensions re-emerge or intensify, there could be a negative impact both on financing conditions and on the current positive Spanish macroeconomic scenario. In 2017, the Telefónica Group obtained 24.3% of its revenues in Spain (24.6% in 2016), 14.0% in Germany (14.4% in 2016) and 12.6% in the United Kingdom (13.2% in 2016).

In Latin America, there is an increasing exchange rate risk created by external factors such as the uncertainty derived from the monetary normalization process in the United States, the continuing low commodity prices in certain cases despite recent improvement, and doubts about growth and imbalances in China. Certain internal factors such as high fiscal and external deficits in major Latin American countries and the low liquidity in certain exchange markets, together with a low productivity growth, hinder a more accelerated progress in economic development and the rebalancing of still existent mismatches.

In Brazil, although the political scenario continues to be unstable, the government has approved relevant legislative reforms and promoted the approval of other key legislative items, such as the social security reform, which could be approved before the end of the term, which has improved the confidence levels in the government. While signs of stabilization have emerged and the economy has started to show positive growth figures, the pace of the recovery is still weak and the unemployment rate remains at 12%. Moreover, despite decreasing external financing needs, internal financing needs remain high. The combination of such elements has led to risks of further downgrades to the country's credit rating, which is already below investment grade, possibly leading to further currency depreciation.

Mexico has a high commercial and financial exposure to the United States, which could generate uncertainty despite having a relatively stable internal outlook, subject to the outcome of the coming general elections and of the renegotiation of the North American Free Trade Agreement (NAFTA), which is now underway. Any increase in interest rates in the United States and/or a possible renegotiation of trade agreements between both 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 2.6% for 2017.

In countries such as Chile, Colombia and Peru, increases in commodity prices are having a positive impact on their respective fiscal and external accounts, but growth continues to be affected by the lower external inflows, which have affected investment and, to a lesser extent, private consumption.

In Argentina, the government is focused on resolving the country's macroeconomic and financial imbalances and on recovering international confidence. The October legislative elections confirmed the good results of the government coalition. However, even though the economy has returned to positive growth rates and the measures taken by the government might continue having positive effects in the medium term, short term risks persist, including exchange rate risk, especially due to the high inflation rate.

In Ecuador, despite the recovery in oil prices and the recent U.S. dollar depreciation, which have allowed for an improvement in economic activity through exports, 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 more vulnerable position against volatility shocks.

During 2017 Telefónica Hispanoamérica represented 24.1% of the Telefónica Group's revenues (24.2% in 2016), of which 27.8% proceeded from revenues in Argentina, 18.5% in Peru and 17.4% in Chile. During 2017, Telefónica Brazil represented 23.1% of the Telefónica Group's revenues (21.3% in 2016). In this respect, 32.4% of the Group's revenues were generated in countries that do not have investment grade status (in order of importance, Brazil, Argentina, Venezuela, Ecuador, Guatemala, El Salvador, Nicaragua and Costa Rica), 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-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 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, 2017, 71.0% 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, 17.2% 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, 2017: (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 91 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 74 million euros, in each case for the year ended December 31, 2017. 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 17 million euros for the year ended December 31, 2017, primarily due to the weakening of the Venezuelan bolivar. These calculations have been made assuming a constant currency position with an impact on profit or loss as of December 31, 2017, taking into account derivative instruments in place.

During 2017, Telefónica Brazil represented 25.9% (24.5% in 2016), Telefónica Hispanoamérica represented 21.9% (23.0% in 2016) and Telefónica United Kingdom represented 10.1% (11.3% in 2016) 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.

In 2017, the evolution of exchange rates had a negative impact on results, decreasing the Group's consolidated revenues and OIBDA by an estimated 3.2 p.p. and 4.7 p.p., respectively, mainly due to the depreciation of the Argentine peso, the Venezuelan bolivar and the pound sterling. Furthermore, translation differences had a positive impact on the Group's equity of 2,049 million euros as of December 31, 2016 and a negative impact of 4,607 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 significant deterioration of conditions in the international or local financial markets due to monetary policies set by central banks, including increases in interest rates and/or balance sheet reductions, and oil price instability, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

As of December 31, 2017, the Group's net financial debt amounted to 44,230 million euros (48,595 million euros as of December 31, 2016) and, as of December 31, 2017, the Group's gross financial debt amounted to 55,746 million euros (60,361 million euros as of December 31, 2016). At such date, the average maturity of the debt was 8.08 years (6.35 years as of December 31, 2016).

As of December 31, 2017, the Group's gross financial debt scheduled to mature in 2018 amounted to 9,414 million euros, and gross financial debt scheduled to mature in 2019 amounted to 6,063 million euros.

In accordance with its liquidity policy, Telefónica has covered its gross debt maturities for the next twelve months with cash and credit lines available at December 31, 2017. As of December 31, 2017, the Telefónica Group had undrawn committed credit facilities arranged with banks for an amount of 13,531 million euros (12,541 million euros of which will expire in more than twelve months). Telefónica's liquidity could be affected if market conditions make it difficult to renew existing undrawn credit lines. As of December 31, 2017, 7.3% of the aggregate undrawn amount under credit lines was scheduled to expire prior to December 31, 2018.

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 standards IFRS 15 "Revenue from Contracts with Customers" and IFRS 9 "Financial instruments", effective from January 1, 2018, and IFRS 16 "Leases", effective from January 1, 2019.

These standards present significant changes that will affect the amount and timing of recognition of revenues and expenses related to certain sales transactions (IFRS 15), the estimation processes for the expected impairment losses on financial assets, the recognition period and the documentation of hedging policies and strategies (IFRS 9), as well as the accounting treatment for all lease contracts, other than certain short-term leases and leases of low-value assets (IFRS 16). The Group estimates that the first-time adoption of these changes will have a material impact on the Group's financial statements and may make comparisons between periods difficult and less meaningful.

Risks Relating to the Group’s Industry

The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.

The telecommunications sector is subject to laws and 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 risks of this nature are those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality. 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 provisions of services in a specific market. The spectrum to which each of the licenses and administrative concessions refers 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.

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 lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses.

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

On September 14, 2016, the European Commission (EC) adopted, among others, a proposed Directive for the establishment of a European Electronic Communication Code (EECC), which could have significant implications, *inter alia*, for access to networks, spectrum use, auction conditions, duration and renewal of licenses, universal service and consumer protection. The proposed Directive is currently going through the legislative process and its approval is expected in the second quarter of 2018.

On May 17, 2017, the European Parliament and Council approved a decision regarding the use and availability of the 700 MHz band. This could require new cash outflows from Telefónica between 2018 and 2022 in the United Kingdom and Spain. The 700 MHz band will initially allow the expansion of the capacity of 4G networks and, in the near future, the introduction of 5G services with new functionalities. In Spain, it is expected that the Ministry of Energy, Tourism and the Digital Agenda publishes its plan to release the 700 MHz band before June 30, 2018, in line with the calendar approved by the EC and with the 5G National Plan adopted in December 2017. The 5G National Plan also contemplates, among other matters, an urgent auction for the 3.6 GHz band at the beginning of 2018 and, possibly, also in the L band (1452- 1492 MHz).

In connection with the spectrum auction for the 2.3 and 3.4 GHz bands in the United Kingdom, on July 11, 2017 the Office of Communications ("**Ofcom**") released rules for the upcoming mobile spectrum auction in both the 2.3 GHz (available for "immediate use") and 3.4 GHz bands (which may be used for 5G services). They set forth two separate spectrum caps: a spectrum cap of 255 MHz of immediately usable spectrum and an overall cap of 340 MHz. Hutchison 3G UK Ltd ("**H3G**") and BT filed a motion to review Ofcom's decision regarding the 3.4 GHz band based on the constraints imposed by the spectrum limits set forth in this band for which they can bid. The judgment was released in December 2017 and both appeals were dismissed. H3G tried to appeal the decision to the Court of Appeal and a hearing took place on February 13, 2018. The appeal was refused and the litigation ended. Therefore, the auction can now proceed without delay. Telefónica UK expects the bidding to start in March 2018.

In Germany, regarding its process to provide new frequencies for the further development of digital infrastructures, the regulatory agency for electricity, gas, telecommunications, post and railway ("**BNetzA**") published its position on the key elements on June 27, 2017 and, at the same time, initiated a procedure for determining the frequency demand for nationwide assignments in the 2 GHz and the 3.6 GHz bands (3.6 GHz is the official wording of BNetza when referring to 3.4-3.8 GHz). Among other things, for the 2 GHz band, BNetzA proposed the joint award of the frequencies expiring at the end of 2020 and 2025 and indicated that, following the merger of Telefónica Deutschland and E-Plus, it does not intend to withdraw any rights of use allocated to Telefónica Deutschland before their expiration (2020 and 2025, respectively). For the 3.6 GHz band, regional assignments for a part of the frequencies are provided for in the paper, as well as mutual co-usage rights between national and regional assignments. Additionally, it also foresees a demand-based supply with 5G. The procedures to auction both bands could begin in 2018 or 2019. The Telefónica Deutschland Group reported its request for frequency by the deadline of September 30, 2017 and commented on the key elements of the proposal. The final determination of the frequency demand and the first draft decisions in this regard are expected in the first quarter of 2018. For frequencies above 24 GHz, BNetzA intends to initially develop an application process in the 26 GHz frequency band.

In Latin America, 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 these licenses. Specifically, the procedures expected to take place in 2018 in jurisdictions that are relevant for the Group are:

- Mexico: An auction of spectrum in the 2500 MHz band is expected to take place in 2018.
- Colombia: In February 2017, the Ministry of Information Technologies and Communications ("ITC") published the conditions for the auction of 70 MHz of spectrum in the 700 MHz band and of 5 MHz of spectrum in the 1900 MHz band. The ITC modified through Decree 2194 of December 27, 2017 the spectrum caps, increasing them by 5MHz for high bands, reaching a total of 90 MHz, and by 15MHz for low bands, reaching a total of 45 MHz. On January 23, 2018, the ITC published a second project on the conditions of the 700 MHz auction, which included certain modifications, such as: the auction mechanism would be based on a multiple-round ascending clock auction, and the obligation to provide free wifi zones would be removed. This second project was subject to comments until February 20, 2018. The schedule for the auction has not yet been set but the ITC has announced that it should take place in 2018.
- Argentina: The government instructed the regulatory authority to issue new regulations during 2017 (i) to ensure the reassignment of frequencies of the radio spectrum for the provision of wireless or fixed wireless services (known as the "refarming process"), which Telefónica has challenged in court, and (ii) to enable the reassignment of frequencies previously granted to other providers (known as the "spectrum on demand process"). In connection with the latter, in May 2017 such "spectrum on demand process" was launched and, in June 2017, certain 2.6 GHz spectrum was granted to Telefónica and other licensed mobile operators, but the effective distribution of the spectrum is still pending.

It is possible that some of the above-mentioned spectrum tender procedures will not be completed, or even initiated within the proposed time frames. In addition to the above, it may be the case that certain administrations which have not yet announced their intention to release new spectrum, may do so during 2018 or 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 the United Kingdom, Telefónica has an obligation under the terms of its 800 MHz spectrum license to provide indoor coverage to 98% of the United Kingdom population (and 95% of the population of each of England, Wales, Scotland and Northern Ireland). It also has an obligation under the terms of its 900/1800 MHz spectrum license to provide voice and text services to 90% of the United Kingdom landmass. Both requirements had to be met by the end of 2017 and must be maintained thereafter. Telefónica United Kingdom continues to invest in its infrastructure improvement program, upgrading its 2G and 3G networks and working on the roll-out of its 4G network. Telefónica United Kingdom is in the process of providing information to the UK's regulatory authority, Ofcom, to demonstrate its compliance with the obligations mentioned above.

In Spain, also related to the licenses of the 800 MHz spectrum band, the assignee operators of 2x10MHz spectrum (Telefónica, Vodafone and Orange) must jointly complete before January 1, 2020 the offering of services provided with other technologies or in other bands of frequency, with the purpose of reaching coverage that allows access, with a speed of 30 megabits per second or faster, to at least 90% of the inhabitants in population units of less than 5,000 inhabitants. In this regard, there was a public consultation process open until January 22, 2018 regarding the way to implement this obligation. In any event, 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 obligations.

In Germany, in connection with the merger of Telefónica Deutschland Holding AG and E-Plus, three legal proceedings remain open before the European General Court against the decision of the EC authorizing such merger. Oral hearings were held in December 2017 and the decisions are expected in the first quarter of 2018.

In the state of São Paulo, Telefônica 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. In accordance with current regulations, Telefônica Brazil informed the Brazilian regulatory authority (*Agencia Nacional de Telecomunicações* or "**ANATEL**") that the net value of assets assigned to the provision of STFC was estimated to total 8,763 million Brazilian reals as of December 31, 2017 (approximately 2,209 million euros under the exchange rate applicable on such date). Under current regulations, Telefónica must update this information by April 30, 2018 by sending the updated list and value of the assets assigned to the provision of STFC as of December 31, 2017. In principle, such assets were considered to be reversible assets, and were thus supposed to be reverted to the Federal Government at the end of the concession agreement. A bill amending the regulatory framework in Brazil is in process, establishing, among other things, that such assets would no longer be reversible under a new license regime in exchange for significant broadband investment commitments. The bill has been approved at both legislative houses but has been challenged before the Federal Supreme Court due to an alleged procedural defect. The outcome of this lawsuit is uncertain, although the Senate's governing board may overcome it by sending the bill for voting in the Plenary (such action depends on the political environment, which is also uncertain). Such Court and, consequently, the Senate's governing board, has each decided to send 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.

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., ESP ("**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 radioelectric 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 28 November 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, were operating 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, after finding on August 4, 2017 that an arithmetic error required that the amount contained in the original award from July 25, 2017 be revised slightly downwards. 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*). In addition, on December 18, 2017, ColTel also filed a constitutional action "*acción de tutela*" seeking to protect its constitutional rights jeopardized by the arbitration award. On the other hand, pursuant to the relevant bilateral treaty, Telefónica notified Colombia of its intention to file a claim in the International Centre for Settlement of Investment Disputes ("**ICSID**") after the expiration of the 90-day notice period. After the expiration of such deadline, on February 1, 2018, Telefónica submitted the arbitration request to the ICSID.

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. In December 2014 and June 2016, Telefónica filed renewal requests for an additional twenty years in relation to a concession for the provision of local carrier services and to one of the concessions to provide mobile line services in certain provinces, respectively. 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.

Telefónica Móviles Chile, S.A. was awarded 2x10 MHz spectrum on the 700 MHz band in March 2014. While services are being provided on such spectrum, a consumer organization filed a claim against the allocation of spectrum on the 700 MHz band that is still pending.

During 2017, the Group's consolidated investment in spectrum acquisitions and renewals amounted to 538 million euros.

Regulation of wholesale services

The EC's proposal in respect of the regulatory framework intends, among other measures, to incorporate a methodology and a European upper limit for the call-termination prices for landline phones/mobile phones (FTRs/MTRs) applicable in the EU. The decreases in wholesale mobile termination rates ("**MTRs**") in Europe are noteworthy. 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, the current rate is 0.495 pence per minute. On June 27, 2017, Ofcom made a consultation on a proposal for a progressive reduction over a three-year period from April 1, 2018, which would result in a 10% reduction in real terms in MTRs during that period.

In Spain, in November 2017, the Spanish National Regulatory and Competition Authority (*Comisión Nacional de los Mercados y la Competencia* or "**CNMC**") submitted to the EC the draft measures to set the new MTRs for all the mobile operators, which would imply a progressive reduction of 40% from current levels. The proposed dates and MTRs would be as follows: since the decision becomes effective until December 31, 2018 at 0.0070 €/min; from January 1, 2019 until December 31, 2019 at 0.0066 €/min; and as from January 1, 2020 at 0.0064 €/min. A final decision was adopted in 2018 setting the rate at 0.0067 €/min during the year 2019.

In Latin America, the Group believes it is likely that MTRs will also be reduced in the short to medium term.

In Brazil, the *Plano Geral de Metas de Competição* ("**PGMC**"), amended by Resolution 649/2015, established that mobile termination fees are subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees are expected to be in force (such Resolution has been challenged in courts and the proceedings are ongoing). On December 5, 2016, ANATEL issued a public consultation for the revision of the PGMC, which addresses changes in the relevant wholesale markets regulated by the PGMC and also in the cost-oriented model. ANATEL is expected to deliberate on the new regulations during 2018.

In Mexico, on November 9, 2017, the *Instituto Federal de Telecomunicaciones* ("**IFT**") announced that the MTRs applicable to the so-called Prevailing Economic Agent ("**PEA**") for 2018 shall be 0. 028562 pesos per minute while the MTRs applicable to the operators other than the PEA shall be 0.112799. The IFT fixed the MTRs on the PEA's network as a result of a prior ruling of the Supreme Court of Justice in favor of the PEA and against its obligation to refrain from charging fees for the termination of mobile, fixed and SMS traffic on its network.

In Peru, the *Organismo Supervisor de las Telecomunicaciones* ("**OSIPTEL**") started in November 2016 the process to amend the maximum MTRs. On January 28, 2018, OSIPTEL published the caps on interconnection rates for MTRs. The approved rate is the same for all networks and entails a decrease of 63% (USD 0.00661 per minute rated at the second). The new fees established by OSIPTEL will apply as of the adoption of the regulation.

As a result of the foregoing regulatory actions, Telefónica may receive lower prices for certain of its services, which may materially adversely affect its business, financial condition, results of operations and/or cash flows. During the year ended December 31, 2017 the negative impact of these regulations is estimated to have resulted in the deduction of approximately 1 percentage point 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 the consumers in a country to a minimum set of services offered at reasonable and fair prices in order to avoid social exclusion. On its proposal for the reform of the regulatory framework issued on September 14, 2016, the EC sought to modernize USO in Europe, removing the mandatory inclusion of the legacy outdated services (telephone boxes, directories and information services) and focusing on the provision of affordable broadband services. The EC also proposed that USO should be funded out of general budgets and not from the sectoral budget. However, if this funding method does not thrive, the inclusion of affordable broadband services could end up being more expensive for the sector. In any case, the new regulation is not expected to be applicable before 2020.

In Spain, the USO for 2017 were extended for 2018, with Telefónica being responsible for the provision of the elements of Universal Service to fixed-broadband access, pay phones and directories.

In Brazil, a proposal of the General Plan for Universalization of Fixed Switched Telephony Services was approved by ANATEL in 2016. The final version, however, has not been published because the amendment to the underlying concession agreement has not been yet finalized.

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

On December 29, 2017, a draft measure on the economic replicability methodology to be used to assess the maximum wholesale access price which Telefónica could charge to other operators for accessing the optical fiber network in regulated areas (NEBA Local and NEBA services), was notified to the EC establishing a maximum wholesale access price of 16.38 €/month. The final decision is expected within the current first quarter of 2018. In June 2017, CNMC launched a public consultation on the methodology to analyze if Telefónica´s business offers can be replicated by other operators.

Any of such obligations and restrictions could raise costs and limit Telefónica's freedom to provide 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, will be directly applicable in all Member States from May 25, 2018. In addition, on January 10, 2017, the EC presented its proposal for a Regulation on privacy and electronic communications ("**ePrivacy**"), 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 2018.

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, has been challenged before the EU's General Court by civil-society groups, but the admission of their appeals is still pending as at the date of this Annual Report. Nevertheless, the EC completed on October 18, 2017 its first annual review on the performance of the Privacy Shield and concluded that the Privacy Shield continues to ensure an adequate level of data protection for personal data of European citizens.

In Brazil, the adoption of a Personal Data Protection Act is still pending. This act could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment.

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.

In Europe, network neutrality is regulated by Regulation (EU) 2015/2120 of November 25, 2015.

Telefónica operates in Latin American countries where net neutrality is being implemented, such as Chile, Colombia, Mexico, Peru (where OSIPTEL implemented regulations on net neutrality on January 1, 2017) and in Brazil. In Mexico, it is expected that IFT will issue guidelines during 2018. In Chile, on November 22, 2016, the Commission of Telecommunications submitted a bill for amending the Network Neutrality Act. The main changes proposed concern the establishment of rules applying measures for traffic management and restrictive rules for "Zero Rating".

If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and/or cash flows.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to various anti-corruption laws, including the 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 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 conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with and cooperating with governmental authorities about these matters and intends to continue to cooperate with those authorities as the investigations continue. It is not possible at this time to predict the scope or duration of these matters or their likely outcome.

Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects Telefónica's competitive position relative to other technology sector companies, and its ability to extract the value generated during the process of digital transformation we are immersed in. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and/or cash flows.

Telefónica may not be able to adequately foresee and respond to technological changes and sector trends.

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances. The entry of new competitors in the markets where the Group is the leader, such as Chile and Peru, has resulted in the Group losing market share in the mobile phone market during the period between 2014 and the end of 2017. In this competitive environment, the Group has focused on its high-value customers and estimates that the loss of revenues has been lower than the loss of accesses.

Failure to adequately anticipate and adapt to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances could have an adverse effect on the Group's business, financial condition, results of operations and/or cash flows.

New products and technologies arise constantly and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 862 million euros in 2017, representing a decrease of 4.8% from 906 million euros in 2016 (1,055 million euros in 2015). These expenses represented 1.7%, 1.7% and 1.9% of the Group's consolidated revenues in 2017, 2016 and 2015, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development ("**OECD**") manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 300MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. In Spain, as of December 2017 Telefónica has already 19.2 million premises passed with fibre (representing 66% of the households), which shows the level of investment required. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of income and additional efficiencies to those traditionally sought. Failure to do so adequately could have an adverse effect on the Group's business, financial condition, results of operations and/or cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond to Telefónica's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency. Any failure by Telefónica Group's IT systems to adequately respond to the Group's evolving operating requirements could have an adverse effect on the Group's business, financial condition and/or results of operations.

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 inappropriate practices are produced by a participant in the supply chain.

As of 31 December 2017, the Telefónica Group depended on three handset suppliers and 10 network infrastructure suppliers, which, together, accounted for 79% and 78%, respectively, for the awarded contracts as of such date (for their products groups). One of the handset suppliers represented two-fifths of all handset allocations 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.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse effect on 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.

Unanticipated network interruptions as a result of system failures, including those due to natural disasters caused by natural or meteorological events (due, in turn, to extreme weather conditions, especially in the geographies with greater exposure to them), network, hardware or software failures, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses have become increasingly dependent on telecommunications and computer networks and adopt 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 on employees with access. Further, our employees or other persons may have unauthorized or authorized access to our systems and/or take actions that affect our 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. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization, that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to Telefónica being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may adversely affect the business, financial conditions, results of operations and/or cash flows of the Telefónica Group.

Possible regulatory, business, economic or political changes could lead to asset impairment.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize 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. No impairments were recognized in 2017. In 2016, impairment losses in goodwill were recognized amounting to an aggregate amount of 215 million euros, relating to Telefónica ´s operations in Venezuela (124 million euros) and in Mexico (91 million euros).

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

Any of the foregoing could have an adverse 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, tax claims, antitrust 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 17 and 20 to the Annual Financial Statements.

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, 2017. 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.

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Our Responsability

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, 2017, in all material respects, an effective Internal Control over Financial Reporting for the period ended at December 31, 2017, 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, 2017 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 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.

Virginia Arce

Virginia Arce Peralta

February 22, 2018