

**SPECIMEN ANNEX I**

**ANNUAL REPORT ON THE REMUNERATION OF DIRECTORS OF LISTED COMPANIES**

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ANNUAL REPORT ON THE REMUNERATION OF DIRECTORS OF LISTED COMPANIES

**A. REMUNERATION POLICY OF THE COMPANY FOR THE CURRENT YEAR**

**A.1 Explain the company's remuneration policy. This section will include information regarding:**

- **General principles and foundations of the remuneration policy.**
- **Most significant changes made to the remuneration policy from the policy applied during the prior fiscal year, as well as changes made during the year to the terms for exercising options already granted.**
- **Standards used and composition of the comparable business groups whose remuneration policies have been examined to establish the company's remuneration policy.**
- **Relative significance of the variable items of remuneration as compared to fixed items and standards used to determine the various components of the director remuneration package (remunerative mix).**

<b>Explain the remuneration policy</b>
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**A.1.1. General principles and foundations of the remuneration policy.**

The guiding principle of the Telefónica Group's remuneration policy is to attract, retain and motivate the most outstanding professionals, in order to enable the Company to achieve its strategic objectives within the increasingly competitive and globalized context in which it operates, adopting the most appropriate measures and practices. Such policy must be in line with the circumstances prevailing at any time, paying particular attention to changes in laws and regulations, best practices, recommendations and trends (both domestic and international) in connection with the remuneration of directors of listed companies and the conditions of the market; accordingly, the content of such policy is periodically reviewed and an assessment is made of the amendments deemed appropriate, in light of the reviews carried out, to submit for approval of the shareholders at the General Shareholders' Meeting.

As regards Directors able to perform executive duties, the guiding principles and standards within the framework described above are:

- **Fairness:** adequately remunerate each Executive Director for his/her professional merit, experience, dedication and responsibilities.

- Transparency: as a paramount principle guiding the Company's corporate governance system.
- Competitiveness: in order to have the best professionals in the market, the remuneration package, both in terms of structure and of overall amount, must be competitive with that of comparable entities at the international level.
- Link between remuneration and results: a significant portion of the total remuneration of the Executive Directors and Senior Executive Officers is variable, and receipt thereof is tied to the achievement of pre-established, specific and quantifiable financial, business and value-creation objectives aligned with the Company's interests.
- Creation of shareholder value in a manner that is sustainable over time.

**A.1.2. Most significant changes made to the remuneration policy from the policy applied during the prior fiscal year, as well as changes made during the financial year to the terms for exercising options already granted.**

The components and features of the remuneration policy to apply during fiscal year 2017 are maintained on terms similar to those adopted in fiscal year 2016.

It is reported that the Company is currently analyzing the possible commencement of new long-term compensation plans. Pursuant to studies being carried out in this area, the Board of Directors might consider proposing the adoption of appropriate resolutions in this regard at the next Annual General Shareholders' Meeting. If this occurs, the details, terms and conditions of such possible plans will be reflected in the proposed resolutions that the Board of Directors submits to the shareholders at such General Shareholders' Meetings.

**A.1.3. Standards used to establish the company's remuneration policy**

The Board of Directors, at the proposal of the Nominating, Compensation and Corporate Governance Committee, takes the following parameters into account in establishing the remuneration policy:

- The provisions of the By-Laws and the Regulations of the Board:

The remuneration system and policy applicable to the Board of Directors of Telefónica, as well as the process for preparation thereof, are established in the By-Laws (article 35) and in the Regulations of the Board of Directors (article 34). Pursuant to the provisions of such texts, the Board of Directors, at the proposal of the Nominating, Compensation and Corporate Governance Committee, determines the amount that Directors, in their capacity as such, are to receive for discharging the duties of supervision and collective decision-making inherent to their position, within the maximum limit set by the shareholders at the Company's Ordinary General Shareholders' Meeting.

The aforementioned remuneration, deriving from membership on the Board of Directors of Telefónica, is compatible with other remuneration received by Directors by reason of the executive duties they perform as delegated or entrusted by the Board of Directors, other than those arising from their status as Directors. Such remuneration is approved by the Board of Directors of the Company, within the

relevant contracts, at the proposal of the Nominating, Compensation and Corporate Governance Committee, and will be adjusted to conform to the Director Remuneration Policy approved by the shareholders at the General Shareholders' Meeting. Remuneration systems that are linked to the listing price of the shares or that entail the delivery of shares or of options thereon are submitted to the decision of the shareholders at the General Shareholders' Meeting of the Company, as provided by applicable law.

- Applicable laws and regulations.
- The objectives established within the Group, which allow, among other things, for the determination of the metrics to which annual and medium/long-term variable remuneration is tied.
- Market data.
- The recommendations of institutional investors and *proxy advisors*, as well as the information received from them during the consultation process carried out by the Telefónica Group.

For more information on these standards, see section A.2.

#### **A.1.4. Relative significance of the variable items of remuneration as compared to fixed items and standards used to determine the various components of the director remuneration package (remunerative mix).**

The total remuneration of Executive Directors is made up of various components, primarily consisting of: (i) fixed remuneration, (ii) short-term variable remuneration, (iii) medium- and long-term variable remuneration, (iv) benefits, and (v) in-kind remuneration. Generally speaking, as regards the remunerative mix, it may be stated that in a standard scenario with targets being met, approximately one-third of the total remuneration is fixed, with variable remuneration accounting for two-thirds.

It is stated for the record that, as from April 8, 2016, the sole Executive Director of Telefónica, S.A. is Mr. José María Álvarez-Pallete López, Executive Chairman of the Company.

As regards Directors in their capacity as such, the aim of the remuneration policy within the framework described above is to adequately remunerate them for their professional merit and experience, as well as for the dedication provided and the responsibilities assumed by them, seeking to ensure that the remuneration paid does not compromise their independent judgment. The remuneration must also be aligned with the Company's business strategy and key objectives.

Along these lines, the remuneration of External Directors 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 and of attendance fees for attending the meetings of such Advisory or Control Committees.

## **A.2 Information regarding preparatory work and the decision-making process followed to determine the remuneration policy, and any role played by the remuneration committee and other control bodies in the configuration of the**

**remuneration policy. This information shall include any mandate given to and the composition of the remuneration committee and the identity of external advisors whose services have been used to determine the remuneration policy. There shall also be a statement of the nature of any directors who have participated in the determination of the remuneration policy.**

## **Explain the process for determining the remuneration policy**

### **A.2.1. Preparatory work and decision-making**

The Nominating, Compensation and Corporate Governance Committee periodically reviews the remuneration of the Board of Directors. This process includes an external competitive remuneration analyses and also takes into account the remuneration policy for the Senior Executive Officers and other Employees of the organization.

A reference market, which is established based on a series of objective standards, is considered in performing the external competitiveness analyses, upon the terms set out below:

1º.- A sufficient number of companies to obtain results that are representative and statistically reliable and sound.

2º.- Data on size (billing, assets, market capitalization and number of employees) such that Telefónica may be placed at the median of the comparison group.

3º.- Geographic distribution: primarily included are companies the parent company of which is located in Continental Europe and in the United Kingdom, as well as representative North American entities in the telecommunications industry that are benchmarks for the Company.

4º.- Scope of responsibility: companies listed both on the IBEX 35 and on the FTSE Eurotop 100, consisting of the top-ranking securities listed on the London Stock Exchange.

5º.- Distribution by sector: multi-sector sample, with homogeneous distribution among areas of activity.

As regards Directors in their capacity as such, the reference market is composed of companies comprising the IBEX-35 stock index, given that Telefónica belongs to this index.

Based on the results of these analyses, the Committee has proposed to the Board that the fixed remuneration of Directors, both in their capacity as such and for the performance of executive duties, not be increased in fiscal year 2017.

Likewise, the Committee analyzed the other items of remuneration (short and long-term variable, and other items) and deferred to the Board for the respective decisions in connection therewith. For purposes of this analysis, the Committee takes into account the reports prepared to this effect by the Department of Planning, Accounting and Control, duly audited and verified by the Audit and Control Committee.

### **A.2.2. Remuneration Committee: Mandate**

The Nominating, Compensation and Corporate Governance Committee, the duties of which are established in article 40 of the By-Laws and article 23 of the Regulations of the Board of Directors, plays a key role in the determination of the Telefónica Group's remuneration policy and in the development and implementation of its components. Its mandate in the area of remuneration consists of continuously reviewing and updating the remuneration system applicable to Directors and Senior Executive Officers and of designing new remuneration plans that enable the Company to attract, retain and motivate the most outstanding professionals, bringing their interests into line with the strategic objectives of the Company.

During fiscal year 2016 and through the date of approval of this report, the most significant activities carried out by the Nominating, Compensation and Corporate Governance Committee in the area of remuneration have been the following:

- Proposal for the establishment and monitoring of the objectives tied to the annual variable remuneration of Executive Directors for fiscal year 2016, and reviewed and proposed the establishment of objectives for fiscal year 2017.
- Evaluation of the fulfillment of objectives tied to the annual variable remuneration of Executive Directors for fiscal year 2015 (paid in 2016) and for fiscal year 2016 (to be paid in 2017).
- Proposals regarding the Annual Director Remuneration Reports, for submission to the Board of Directors and subsequent submission to the Ordinary General Shareholders' Meeting held in 2016, and to be held in 2017.

### **A.2.3. Remuneration Committee: Composition**

Pursuant to article 40 of the By-Laws and 23 of the Regulations of the Board of Directors, the Committee shall be composed of not less than three Directors appointed by the Board of Directors; they must be external or non-executive Directors, and the majority of them must be independent Directors. It is also provided that the Chairman of this Committee shall be an independent Director in all cases.

To this effect, the Committee is presided by Mr. Francisco Javier de Paz Mancho, with the Members being: Mr. Peter Erskine, Ms. Sabina Fluxà Thienemann, Mr. Gonzalo Hinojosa Fernández de Angulo and Mr. Pablo Isla Álvarez de Tejera.

In this regard, it is noted that on April 8, 2016, Mr. Alfonso Ferrari Herrero and Mr. Carlos Colomer Casellas, until then Chairman and Member, respectively, of the Nominating, Compensation and Corporate Governance Committee, ceased to hold office as Directors of Telefónica, S.A. Mr. Francisco Javier de Paz Mancho was appointed member and Chairman of the Committee on April 8, 2016, and Ms. Fluxà was appointed Member of the Committee on April 27, 2016.

### **A.2.4. Remuneration Committee: External Advisors**

For the better performance of its duties, the Committee may request the Board to engage legal, accounting or financial advisors or other experts at the Company's expense.

In 2016, the following external advisors provided services to the Committee:

- Garrigues advised the Committee on matters related to benefit plans and contracts of the Executive Directors.
- Kepler advised the Committee in connection with the long-term share incentive plan. As it has been doing for years, Kepler analyzes the performance and level of achievement of each of the stock lifecycles on a quarterly basis.

TRANSEARCH has also advised on the preparation of this Remuneration Report.

**A.3 State the amount and nature of the fixed components, with a breakdown, if applicable, of remuneration for the performance by the executive directors of the duties of senior management, of additional remuneration as chair or member of a committee of the board, of attendance fees for participation on the Board and the committees thereof or other fixed remuneration as director, and an estimate of the annual fixed remuneration to which they give rise. Identify other benefits that are not paid in cash and the basic parameters upon which such benefits are provided.**

#### **Explain the fixed components of remuneration**

##### **Remuneration of the Directors in their capacity as such.**

Remuneration of the Directors in their capacity as such is structured, within the legal and by-law framework, in accordance with the standards and items of remuneration listed below, within the maximum limit determined for such purpose at the General Shareholders' Meeting, in accordance with the provisions of article 35 of the By-Laws.

In accordance with the foregoing, the Ordinary General Shareholders' Meeting held on April 11, 2003 set at 6 million euros the maximum amount of annual gross remuneration to the Directors in their capacity as members of the Board of Directors.

In any case, the above remuneration is the maximum amount; the Board of Directors reserves the right to distribute the amount among the different items and among the different Directors in the manner, time and proportion it freely chooses.

In particular, for fiscal year 2017, remuneration is made up of the following items:

- Fixed amount: annual fixed amount payable on a monthly basis, in line with market standards, in accordance with the positions held by each Director on the Board and the Committees thereof, broken down as follows:
  - Board of Directors:
    - Chairman: 240,000 euros
    - Vice Chairman: 200,000 euros
    - Non-executive Member: 120,000 euros

- Based on Mr. Alierta Izuel's special commitment as Director of Telefónica to the development of the Group's institutional relations, Mr. Alierta Izuel has a special annual fixed amount (in addition to what he is entitled as a Member of the Board of Directors and as a member of any of its Committees) of 500,000 euros.
- Executive Commission:
  - Chairman: 80,000 euros
  - Vice Chairman: 80,000 euros
  - Non-executive Member: 80,000 euros

In this regard, 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).

- Advisory or Control Committees:
  - Chairman: 22,400 euros
  - Non-executive Member: 11,200 euros
- Attendance fees: Directors do not receive fees for attending the meetings of the Board of Directors or of the Executive Commission, and only receive fees for attending meetings of the Advisory or Control Committees. The amount received by each Director at each of the meetings attended thereby comes to 1,000 euros.
- Other remuneration: External Directors also receive the remuneration to which they are entitled for belonging to certain Management Decision-making Bodies of some Subsidiaries and affiliates of Telefónica.

#### **Remuneration of the Directors for the performance of executive duties.**

Executive Directors receive annual fixed remuneration, payable monthly, for the performance of executive duties at the Company. This remuneration shall be set by the Board, upon a proposal of the Nominating, Compensation and Corporate Governance Committee, in a manner consistent with the level of responsibility and leadership within the organization, promoting the retention of key professionals and attracting the best talent, and providing economic independence sufficient to balance the value of other remuneration items.

Annual gross fixed remuneration may be reviewed annually on the basis of criteria approved at any time by the Nominating, Compensation and Corporate Governance Committee. The maximum annual increase shall not exceed 10% of the gross annual salary of the previous year.

In certain situations, such as a change of responsibility, the development of the position and/or special needs for retention and motivation, the Committee may decide to apply higher increases. The underlying reasons shall be explained in the annual report on remuneration of the Directors.

As already stated, as from April 8, 2016, the sole Executive Director of Telefónica, S.A. is its Executive Chairman, Mr. José María Álvarez-Pallete López, for whom is established a fixed remuneration of 1,923,100 euros for fiscal year 2017. This compensation is equal to the one



received in the year 2016, that 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 for the 2016 fiscal year.

#### **A.4 Explain the amount, nature and main features of the variable components of the remuneration systems.**

**In particular:**

- **Identify each of the remuneration plans of which the directors are beneficiaries, the scope thereof, the date of approval thereof, the date of implementation thereof, the date of effectiveness thereof, and the main features thereof. In the case of share option plans and other financial instruments, the general features of the plan shall include information on the conditions for the exercise of such options or financial instruments for each plan.**
- **State any remuneration received under profit-sharing or bonus schemes, and the reason for the accrual thereof;**
- **Explain the fundamental parameters and rationale for any annual bonus plan.**
- **The classes of directors (executive directors, external proprietary directors, external independent directors or other external directors) that are beneficiaries of remuneration systems or plans that include variable remuneration.**
- **The rationale for such remuneration systems or plans, the chosen standards for evaluating performance, and the components and methods of evaluation to determine whether or not such evaluation standards have been met, and an estimate of the absolute amount of variable remuneration to which the current remuneration plan would give rise, based on the level of compliance with the assumption or goals used as the benchmark.**
- **If applicable, information shall be provided regarding any payment deferral periods that have been established and/or the periods for retaining shares or other financial instruments.**

<b>Explain the variable components of the remuneration systems</b>
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The remuneration policy provides that only the Executive Directors have items with a variable component, which are as follows:

i) Short-term variable remuneration (bonus):

Short-term variable remuneration is tied to the achievement of a combination of economic/ financial, operational and qualitative specific, predetermined and measurable objectives, aligned with the corporate interest and in line with the Company's Strategic Plan.

The quantitative objectives (generally, economic/financial and operational objectives) carry a maximum weight of 80% of the overall incentive. They consist of metrics that ensure the right balance between the financial and operational aspects of the management of the Company.

The qualitative objectives carry a maximum weight of 20% of the overall incentive.

The Nominating, Compensation and Corporate Governance Committee is responsible for approving these objectives at the beginning of each fiscal year and for evaluating compliance therewith, once ended. This assessment is performed on the basis of the audited results, which are analyzed, first, by the Audit and Control Committee, as well as on the basis of the extent to which the objectives are met. Following this examination, the Nominating, Compensation and Corporate Governance Committee prepares a bonus proposal that is submitted to the Board of Directors for approval. The Nominating, Compensation and Corporate Governance Committee also takes into account the quality of results over the long term and any associated risks in making the proposal on variable remuneration.

In order to ensure that annual variable remuneration is effectively connected with the professional performance of the beneficiaries economic effects (whether positive or negative) resulting from extraordinary events that could distort the evaluation results are eliminated in order to determine the level of achievement of the quantitative objectives.

The range of performance, set at the beginning of each fiscal year, includes a minimum threshold below which no incentive is payable, a target level, which corresponds with 100% fulfillment of the objectives, and a maximum which is specific to each metric.

In calculating variable remuneration, the degree of fulfillment and the weighting of each of the objectives –individual and/or overall– shall be considered, and internal rules and procedures shall apply for assessing objectives established by the Company for its Senior Executive Officers.

The annual bonus is paid entirely in cash.

The terms of the annual variable remuneration system applicable to Executive Directors, including the structure, maximum remuneration levels, objectives set and the weight of each, are reviewed annually by the Nominating, Compensation and Corporate Governance Committee, taking into account the strategy of the Company and the needs and situation of the business, and are subject to approval by the Board of Directors.

Thus, in 2016 a change was approved in the weighting of the performance indicators (KPIs) on which the 2016 bonus calculation is based, with a 5% reduction in the weight of goals linked to Operating Income Before Depreciation and Amortization ("OIBDA"), increasing by the same percentage the weight given to goals linked to Cash Flow, which also became measured as Free Cash Flow, set at 20%, with the rest of the indicators and weightings remaining the same.

This change is intended to maintain the customer service target, as a central pillar of business development, and to strengthen the focus on the generation of Cash Flow by the Senior Executive Officers of the Telefónica Group.

Thus, for fiscal year 2017, following a proposal of the Committee, the Board has selected those quantifiable and measurable metrics that best reflect the drivers of value creation within the Group. These metrics and their relative weight are as follows:

- 80% of the objectives are operational and financial:
  - 30% of the objectives are tied to OIBDA, which reflects both the Group's growth and progress in operating performance.
  - 30% of the objectives are tied to operating revenue ("Operating Revenue"), which is used to measure the Group's growth.
  - 20% of the objectives are tied to Free Cash Flow ("Free Cash Flow"), the generation of which makes it possible to reduce the debt load.
- The remaining 20% of the objectives are qualitative, referring to the satisfaction level of the Group's customers, and they are measured by the Audit and Control Committee by using the standard criteria applicable to such indices.

The amount of the 2017 target bonus of the Executive Chairman, Mr. José María Álvarez-Pallete López, which would be reached if 100% of the pre-established targets are met, would increase to 180% of his fixed remuneration. The maximum amount of the 2017 bonus of the Executive Chairman could reach up to 225% of his fixed remuneration.

ii) Medium- and long-term variable (multi-annual) remuneration:

The Executive Directors participate in variable medium- and long-term remuneration schemes consisting of the delivery of Telefónica shares, tied to the achievement of medium- and long-term objectives.

As of the date of approval of this report, only the first and second cycle of the second "Performance & Investment Plan" approved at the Ordinary General Shareholders' Meeting held on May 30, 2014 are in effect. The first cycle of this Plan began in 2014 and will end in October 2017. The second cycle of this Plan began in 2015 and will end in October 2018. As regards the third cycle of this Plan (2016-2019), the Board of Directors of the Company, after a favorable report from the Nominating, Compensation and Corporate Governance Committee, resolved not to execute or implement this cycle after finding that it was not sufficiently aligned with the strategic planning of the Telefónica Group, taking into account the circumstances and the macroeconomic environment.

**A.5 Explain the main features of the long-term savings systems, including retirement and any other survival benefit, either wholly or partially financed by the company, and whether funded internally or externally, with an estimate of the equivalent annual amount or cost thereof, stating the type of plan, whether it is a defined-contribution or -benefit plan, the conditions for the vesting of economic rights in favor of the directors, and the compatibility thereof with any kind of indemnity for advanced or early termination of the labor relationship between the company and the director.**

**Also state the contributions on the director's behalf to defined-contribution pension plans; or any increase in the director's vested rights, in the case of contributions to defined-benefit plans.**

<b>Explain the long-term savings systems</b>
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The Executive Chairman, Mr. José María Álvarez-Pallete López, participates in the Telefónica Employee Pension Plan (the "Pension Plan"). The Pension Plan is a defined-contribution plan, with contributions being made by the Company in an amount equal to 6.87% of the base salary, plus 2.2% as a mandatory contribution to be made by the Executive Director up to the maximum annual limit that the law provides at any given time.

The contingencies covered by this Pension Plan are: retirement; death of the participant; death of the beneficiary; total and permanent incapacity to work in one's usual profession, absolute and permanent incapacity for all work and serious disability; and severe or major dependency of the participant.

The benefit consists of the economic right accruing to the beneficiaries as a result of the occurrence of any of the contingencies covered by this Pension Plan. It shall be quantified according to the number of units of account that correspond to each participant based on the amounts contributed to the Pension Plan, and shall be valued for purposes of their payment according to the value of the unit of account as of the business day preceding the date on which the benefit becomes effective.

The participant may also exercise his or her vested rights, in whole or in part, on an exceptional basis in the event of serious illness or long-term unemployment.

The Pension Plan is included within the "Fonditel B Pension Fund," managed by Fonditel Pensiones, EGFP, S.A.

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., covers the same contingencies as the Pension Plan and the same exceptional liquidity events in case of serious illness or long-term unemployment.

The Executive Chairman also participates in an Executive Benefits Plan (*Plan de Previsión Social de Directivos*) ("PPSD"), approved in 2006 to supplement the current Pension Plan. Under the PPSD, Telefónica makes contributions based on 35% of the participant's remuneration. Contributions made to the Pension Plan calculated according to this percentage are deducted from the aforementioned contributions.

Since the Executive Benefits Plan took effect, the implementation vehicle has been a unit-link type collective life insurance policy entered into with Seguros de Vida y Pensiones Antares, S.A.

The contingencies covered by the PPSD are retirement, early retirement, permanent loss of working capacity consisting of total or absolute incapacity or serious disability, and death.

In accordance with the provisions of the general terms and conditions of the PPSD, there is no vesting of economic rights in favor of the Senior Executive Officers. The amount of the benefit of this guarantee will be equivalent to the mathematical provision accruing to the insured on the date on which the policyholder provides notice and authorizes the insurer access to this situation.

Receipt of any compensation derived from termination of the employment relationship shall be inconsistent with the recognition of any economic entitlement to the accumulated mathematical benefit.

**A.6 State any termination benefits agreed to or paid in case of termination of duties as a director.**

**Explain the termination benefits**

No provision has been made for payment of termination benefits to Directors in the event of termination of their duties as such.

Provision is only made for payment of termination benefits in the event of termination of the executive duties, if any, that Directors perform, as explained in section A.7. below.

**A.7 State the terms and conditions that must be included in the contracts of executive directors performing senior management duties. Include information regarding, among other things, the term, limits on termination benefit amounts, continuance in office clauses, prior notice periods, and payment in lieu of prior notice, and any other clauses relating to hiring bonuses, as well as benefits or golden parachutes due to advanced or early termination of the contractual relationship between the company and the executive director. Include, among other things, any clauses or agreements on non-competition, exclusivity, continuance in office or loyalty, and post-contractual non-competition.**

**Explain the terms of the contracts of the executive directors**

The contracts governing the performance of duties and the responsibilities of each Executive Director and of Telefónica include the clauses that are ordinarily contained in these types of contracts, taking into account customary market practices in this regard, and seek to attract and retain the most outstanding professionals and to safeguard the legitimate interests of the Company.

The most significant terms and conditions of such contracts are described below.

**a) Exclusivity, non-competition and termination benefits**

The contract executed with Executive Chairman provides for an indefinite term and includes a non-competition clause. Such clause provides that, upon termination of the respective contract and for the term of the agreement (two years following termination of the contract for any reason), the Executive Chairman may not render services, directly or indirectly, for his/her own account or on behalf of others, personally or through third parties, to Spanish or foreign companies whose business is the same as or similar to that of the Telefónica Group.

The contract with the Executive Chairman also prohibits, during the term thereof, the execution (whether personally or through intermediaries) of other employment, commercial or civil contracts with other companies or entities carrying out activities similar in nature to those of the Telefónica Group.

Finally, the contract executed with the Executive Chairman provides that his relationship is compatible with the holding of other representative and management positions and with other professional situations in which he may be engaged at other entities within the Telefónica Group or at any other entities unrelated to the Group with the express knowledge of the Nominating, Compensation and Corporate Governance Committee and of the Board of Directors.

As regards the terms relating to termination of the contracts, the Executive Chairman, Mr. José María Álvarez-Pallete López, maintains the terms of his prior contract, which provides for an agreed financial severance payment for termination of the relationship, if applicable, which can reach a maximum of four times annual salary. Each annual salary amount includes the last fixed remuneration and the arithmetic mean of the sum of the last two annual variable remuneration amounts received under the contract.

#### **b) Prior notice**

As regards prior notice in the event of termination of the contract, the Executive Director has the duty to give prior notice in the event of such Executive Director's unilateral decision to terminate the contract; it is provided that notice of such unilateral decision must be provided in writing and not less than three months in advance, except in the event of force majeure. If such duty is breached, he/she must pay to the Company an amount equal to the fixed remuneration accrued during the period for which no prior notice was given.

The contract does not include clauses regarding continuance in office.

#### **c) Confidentiality and return of documents**

While the relationship remains in effect and also following termination thereof, the duty of confidentiality applies to all information, data and any reserved or confidential documents of which the Executive Director is aware and to which the Executive Director has had access as a consequence of holding office.

#### **d) Duty to comply with the regulatory system**

Also included is the duty to observe all rules and obligations established in Telefónica's regulatory system, which are set forth in Telefónica's Regulations of the Board of Directors and Internal Rules of Conduct in the Securities Markets, among other rules.

### **A.8 Explain any supplemental remuneration accrued by the directors in consideration for services provided other than those inherent in their position.**

<b>Explain the supplemental remuneration</b>
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The remuneration policy does not provide for any additional remuneration other than that mentioned above.

As of the date of issuance of this Report, there is no supplemental remuneration accrued in favor of the Directors in consideration for services provided other than those inherent in their position.

**A.9 State any remuneration in the form of advances, loans or guarantees provided, with an indication of the interest rate, main features, and amounts potentially returned, as well as the obligations assumed on their behalf as a guarantee.**

**Explain the advances, loans and guarantees provided**

The remuneration policy provides for the possibility of granting advances, loans and guarantees to or on behalf of the Directors.

As of the date of issuance of this Report, no advances, loans or guarantees have been provided to or on behalf of any Director.

**A.10 Explain the main features of in-kind remuneration.**

**Explain the in-kind remuneration**

In addition to life insurance with death or disability coverage described in section A.5, the Executive Chairman receives general health insurance and dental coverage as in-kind remuneration, and is assigned a company vehicle, all in line with the general policy applicable to the Senior Executive Officers of the Company.

In addition, under the “Global Incentive Share Purchase Plan for Employees” (“GESP”) approved at the Ordinary General Shareholders’ Meeting held on May 30, 2014, the Employees of Telefónica, including the Executive Chairman for this purpose, may acquire Telefónica shares in an annual maximum amount of 1,800 euros over a twelve-month period (purchase period). The Company will deliver, free of charge, a number of shares equal to the number of acquired shares subject to the condition of continued employment for one year following the purchase period (vesting period). Continued employment and maintenance of the shares purchased for one year following the purchase period is required in order to receive the same number of shares as those acquired at no charge. This Plan is being implemented as of the date of issuance of this Report, with the Executive Director participating therein.

Likewise, Telefónica has obtained D&O civil liability policy for Directors, Senior Executive Officers and Staff with similar duties of the Telefónica Group, with the usual conditions for this type of insurance. Such policy also extends to the Entity (Telefónica S.A.) and its subsidiaries in certain cases.

**A.11 State the remuneration accrued by the director by virtue of payments made by the listed company to a third party to which the director provides services, if such payments are intended to provide remuneration for the services thereof at the company.**



**Explain the remuneration accrued by the Director by virtue of the payments made by the listed company to a third party to which the Director provides services**

As of the date of issuance of this Report, no such remuneration has accrued.

**A.12 Any item of remuneration other than those listed above, of whatever nature and provenance within the group, especially when it is deemed to be a related-party transaction or when the making thereof detracts from a true and fair view of the total remuneration accrued by the director.**

**Explain the other items of remuneration**

As of the date of issuance of this Report, the Director remuneration system does not provide for any additional item of remuneration other than those explained in the preceding sections.

**A.13 Explain the actions taken by the company regarding the remuneration system in order to reduce exposure to excessive risk and align it with the long-term goals, values and interests of the company, including any reference to: measures provided to ensure that the remuneration policy takes into account the long-term results of the company, measures establishing an appropriate balance between the fixed and variable components of remuneration, measures adopted with respect to those categories of personnel whose professional activities have a significant impact on the entity's risk profile, recovery formulas or clauses to be able to demand the return of the variable components of remuneration based on results if such components have been paid based on data that is later clearly shown to be inaccurate, and measures provided to avoid any conflicts of interest.**

**Explain actions taken to reduce risks**

A.13.1. Telefónica's remuneration policy has been designed by taking into account the Company's strategy and results over the long term:

- The total remuneration of the Executive Chairman and Senior Executive Officers is made up of various items, primarily consisting of: (i) fixed remuneration, (ii) short-term variable remuneration and (iii) medium- and long-term variable remuneration. In the case of the Executive Chairman, this long-term component accounts for 30% to 40% of the total remuneration in a scenario of standard achievement of objectives (fixed + short-term variable + medium- and long-term variable). It is hereby stated that these conditions do not vary from the ones assigned as Chief Executive Officer.

- Medium- and long-term variable remuneration plans are designed as multi-annual in order to ensure that the evaluation process is based on long-term results and that the underlying economic cycle of the Company is taken into account. This remuneration is granted and paid in the form of shares based on the creation of value, such that the Directors' interests are aligned with those of the shareholders. In addition, they involve overlapping cycles that



generally follow one another indefinitely over time, with a permanent focus on the long term in all decision-making.

A.13.2. Telefónica's remuneration policy establishes an appropriate balance between the fixed and variable components of remuneration:

- The design of the remuneration scheme provides for a balanced and efficient relationship between fixed and variable components: in a scenario of standard achievement of the objectives tied to variable remuneration, the fixed remuneration of the Executive Chairman accounts for approximately one-third of the total remuneration (fixed + short-term variable + medium- and long-term variable). This proportion is deemed to be sufficiently high and not excessive, and allows in certain cases of failure to achieve objectives for no amount to be received as variable remuneration.

- Thus, the variable components of remuneration are flexible enough to allow for modulation, to the extent that they may be eliminated altogether. In a scenario where objectives tied to variable remuneration are not achieved, the Executive Chairman and Senior Executive Officers would only receive fixed remuneration.

- There is no guaranteed variable remuneration. Such remuneration is exceptional in nature and only applies after the first year of employment of new personnel.

As regards measures adopted with respect to those categories of personnel whose professional activities have a significant impact on the entity's risk profile:

- The Nominating, Compensation and Corporate Governance Committee is responsible for reviewing and analyzing the remuneration policy and the implementation thereof. Approximately 1,100 Senior Executive Officers fall within the scope of the Committee's work. This group includes professionals whose activities may have a significant impact on the entity's risk profile.

- The Company's Audit and Control Committee also participates in the process of decision-making in connection with the short-term variable remuneration (bonus) of the Executive Chairman, by verifying the economic/financial information that may be included as part of the objectives set for purposes of such remuneration, as this Committee must first verify the Company's results as a basis for calculation of the respective objectives.

- The Nominating, Compensation and Corporate Governance Committee is made up of 5 members, 2 of whom are also members of the Audit and Control Committee. The interlocking presence of Directors in these two Committees ensures that the risks associated with remuneration are taken into account in the discussions at both Committees and in their proposals to the Board, both for purposes of the determination and in the process of evaluation of annual and multi-annual incentives.

A.13.3. With respect to claw-back formulas or clauses to be able to demand the return of the variable components of remuneration based on results if such components have been paid based on data that is later clearly shown to be inaccurate, and measures provided to avoid any conflicts of interest, one should take into account that:

- The Nominating, Compensation and Corporate Governance Committee has the power to propose to the Board of Directors that payment of variable remuneration be cancelled in these circumstances.

- Furthermore, the Nominating, Compensation and Corporate Governance Committee must evaluate whether exceptional circumstances of this kind may even lead to termination of the

relationship with the respective responsible party or parties, proposing to the Board of Directors the adoption of such measures as may be appropriate.

## **B REMUNERATION POLICY FOR FUTURE FISCAL YEARS**

**Deleted.**

## **C OVERALL SUMMARY OF THE APPLICATION OF THE REMUNERATION POLICY DURING THE FISCAL YEAR JUST ENDED**

**C.1 Summarize the main features of the structure and items of remuneration from the remuneration policy applied during the fiscal year just ended, which give rise to the breakdown of individual remuneration accrued by each of the directors as reflected in section D of this report, and provide a summary of the decisions made by the board to apply such items.**

**Explain the structure and items of remuneration from the remuneration policy applied during the fiscal year**

1º.- Concerning **Directors in their capacity as such**, the structure and items of remuneration of the remuneration policy applied during fiscal year 2016 are described below:

- Fixed amount deriving from membership on the Board, Executive Commission and Advisory or Control Committees: 3,143,201 euros.

- Fees for attending the meetings of the Advisory or Control Committees: 221,000 euros.

- Remuneration for membership in certain Management Decision-making Bodies of some subsidiaries and affiliates of Telefónica, and to the Territorial Advisory Councils (Andalusia, Catalonia and Valencia) and Regional and Business Advisory Councils (Spain, Latin America and United Kingdom): 799,179 euros.

It is noted that, from January 2017, and in order to reach the highest level of efficiency possible and to optimize the management of Telefónica, S.A., the Advisory Boards of the Telefónica Group were eliminated, thus were eliminated the Advisory Boards of Telefónica España, Telefónica UK and Telefónica Latinoamérica, as well as the Territorial Boards of Andalusia, Catalonia and Valencia.

The amounts set forth above are aggregate amounts for all of the Directors.

2º.- **As regards Executive Directors**, the structure and items of remuneration from the remuneration policy applied during fiscal year 2016 are described below:

### ***i) Fixed Remuneration***

Pursuant to the contracts approved by the Board, at the proposal of the Nominating, Compensation and Corporate Governance Committee, the fixed remuneration of Executive Directors for fiscal year 2016 came to an overall amount of 2,849,597 euros. This figure includes the amounts corresponding to Mr. José María Álvarez-Pallete López, Mr. César Alierta Izuel and Mr. Santiago Fernández Valbuena (for the latter two, they are the amounts received through April 8, 2016, the date on which Mr. Alierta ceased to be Executive Director, becoming an Other External Director, and Mr. Fernández Valbuena ceased to be a

Director of the Company). It is noted that Mr. Santiago Fernández Valbuena collected his remuneration in Brazilian reais and, accordingly, the stated amount of his remuneration in euros may vary depending on the exchange rate applicable at any particular time.

**ii) Short-term Variable Remuneration (annual)**

As regards the 2016 bonus, payable in 2017, the Nominating, Compensation and Corporate Governance Committee monitored the established objectives throughout the year, performing a final evaluation based on the audited results for fiscal year 2016 (which are first examined by the Audit and Control Committee) and on the level of achievement of the objectives. Following this examination, the Nominating, Compensation and Corporate Governance Committee prepares a bonus proposal that is submitted to the Board of Directors for approval. The Committee also takes into account the quality of results over the long term and any associated risks in making the proposal on variable remuneration.

During the process of evaluation of the objectives set for fiscal year 2016, the Nominating, Compensation and Corporate Governance Committee reviewed the following:

- Quantitative objectives: Operating Income Before Depreciation and Amortization (OIBDA), Operating Revenue and Free Cash Flow.
- Qualitative objectives, represented by the level of satisfaction of the Group's customers.

On February 22, 2017, after evaluating the level of achievement of the above objectives, the Board of Directors, upon a proposal of the Nominating, Compensation and Corporate Governance Committee, approved an overall achievement level of 99.1%. Therefore, the annual variable remuneration level is set at 79.28% of the maximum.

As a result of the foregoing, the amount to be received by the Executive Chairman, Mr. José María Álvarez-Pallete López, during the first quarter of 2017 for the 2016 bonus (meeting 2016 targets) is 3,430,430 euros.

A breakdown of the level of achievement of the objectives is provided in section D.2. of this report.

**iii) Medium- and Long-term Variable Remuneration (multi-annual):**

In 2016, Telefónica's medium- and long-term variable remuneration policy was implemented through two plans:

a) The first "Performance & Investment Plan" ("PIP") approved by the shareholders at the Ordinary General Shareholders' Meeting held on May 18, 2011, the first cycle of which began in 2011 and ended in July 2014; the second cycle of which began in 2012 and ended in July 2015; and the third cycle of which began in 2013 and ended in July 2016.

The third cycle of this Plan, which began in 2013, ended in 2016. In order to determine the specific number of shares to be delivered at the end of such cycle, Kepler provided to the Nominating, Compensation and Corporate Governance Committee the calculation of Telefónica's Total Shareholder Return ("TSR") compared to this same metric at the companies included in the Dow Jones Global Sector Titans Telecommunications Index

during the same period. In order to determine the level of achievement attained, the following scale, established at the beginning of the plan, was used:

- If the Telefónica TSR percentile is below the median, 0% of the allotted shares are vested.
- If the Telefónica TSR percentile coincides with the median, 30% of the allotted shares are vested.
- If the Telefónica TSR percentile falls within the upper quartile, 100% of the allotted shares are vested.
- Intermediate figures are calculated by linear interpolation.

Telefónica's TSR ended below the median according to the established scale of achievement. Therefore, the Participants in the third cycle of the first PIP, which includes the Executive Directors in 2016, were not entitled to receive any of the theoretical shares allotted in 2013.

b) The second "Performance & Investment Plan" ("PIP") approved by the shareholders at the Ordinary General Shareholders' Meeting held on May 30, 2014, the first cycle of which began in 2014 and will end in July 2017; the second cycle of which began in 2015 and will end in July 2018; and the third cycle of which would have begun in 2016.

Set out below is the maximum number of theoretical shares allocated (without co-investment), as well as the potential maximum number of shares to be received upon compliance with the "co-investment" requirement established in such second PIP and maximum completion of the TSR target set for the first and second cycle of the plan that would correspond to Telefónica's Directors for the performance of their executive duties:

#### **SECOND PIP - First Cycle / 2014-2017**

Directors	Theoretical shares allocated (without co-investment)	Potential maximum number of shares (*)
Mr. José María Álvarez-Pallete López	192,000	300,000
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.

#### **SECOND PIP - Second Cycle / 2015-2018**

Directors	Theoretical shares allocated (without co-investment)	Potential maximum number of shares (*)
Mr. José María Álvarez-Pallete López	192,000	300,000
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.

In any event, it is noted that no shares have been delivered to the Executive Directors under either the first or the second cycle of the second PIP and that the table above only reflects the number of shares potentially deliverable under various scenarios, without in any way meaning that all or part thereof will actually be delivered.

In fact, the number of shares of Telefónica, S.A., always within the maximum limit, that might be delivered to the Participants is subject to and determined by the Total Shareholder Return ("TSR") of the Telefónica, S.A. shares during the cycle (3 years), as compared to TSRs experienced by certain companies within the telecommunications sector, weighted according to their relevance to Telefónica, S.A. which shall constitute the comparison group (hereinafter, the "Comparison Group") for purposes of the Plan. The companies included in the Comparison Group are the following: *America Movil, BT Group, Deutsche Telekom, Orange, Telecom Italia, Vodafone Group, Proximus, Royal KPN, Millicom, Oi, Swisscom, Telenor, TeliaSonera and Tim Participações.*

The achievement scale approved by the Board is the following: if the TSR performance of Telefónica, S.A. shares is within at least the median of the Comparison Group, the number of shares to be delivered will be 30% of the maximum. If performance falls in the third quartile of the Comparison Group, the number of shares to be delivered shall be 100% of the maximum. Those cases falling between the median and the third quartile shall be calculated by linear interpolation. If the TSR of Telefónica, S.A. falls within the ninth decile or higher, the delivery rate will be higher than 100%, up to a maximum of 125%, calculated by linear interpolation between said third quartile and the ninth decile.

#### **SECOND PIP - Third Cycle / 2016-2019**

As regards the third cycle of this Plan (2016-2019), the Board of Directors of the Company, after a favorable report from the Nominating, Compensation and Corporate Governance Committee, resolved not to execute or implement this cycle after finding that it was not sufficiently aligned with the strategic planning of the Telefónica Group, taking into account the circumstances and the macroeconomic environment.

#### ***iv) Benefits***

In line with the general policy for Executive Officers, Directors who have been Executive Directors at any time during fiscal year 2016 have received various benefits, such as a Company vehicle, as well as the following benefits, the amount of which are itemized in section D:

- General health and dental insurance coverage.
- Life insurance with death or disability coverage.
- Benefits plan systems:

The Executive Chairman participates in the Telefónica Group Employee Pension Plan (the "Pension Plan"). As of December 31, 2016, the amount relating to vested rights is as follow:

- Mr. José María Álvarez-Pallete López: 252,023 euros.

Mr. César Alierta Izuel, Ms. Eva Castillo Sanz and Mr. Julio Linares López participated in this Pension Plan during the time that they were Executive Directors of the Telefónica Group. As of December 31, 2016, the amounts relating to vested rights are as follows:

- Mr. César Alierta Izuel: 370,566 euros.
- Ms. Eva Castillo Sanz: 42,232 euros.

- Mr. Julio Linares López: 628,710 euros.

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., covers the same contingencies as the “Pension Plan” and the same exceptional liquidity events in case of serious illness or long-term unemployment.

As of December 31, 2016, the mathematical provision in this insurance is as follows:

- Mr. José María Álvarez-Pallete López: 253,728 euros.
- Mr. César Alierta Izuel: 135,951 euros.

There is also an Executive Benefits Plan (*Plan de Previsión Social de Directivos*) (“PPSD”), approved in 2006 to supplement the current Pension Plan.

In accordance with the provisions of the general terms and conditions of this plan, there is no vesting of economic rights. The entitlements as of December 31, 2016 were as follows:

- Mr. José María Álvarez-Pallete López: 6,774,162 euros.
- Mr. César Alierta Izuel: 14,921,767 euros.
- Ms. Eva Castillo Sanz: 977,072 euros.

A breakdown of the contributions made is described in section D.1.a) iii) Long-term savings systems of the Report. It is noted that the change in accumulated funds reflected in such section D.1.a) iii) is due to both contributions made as well as the changes in the value thereof.

#### **v) Other Payments**

The third edition of the Telefónica, S.A. Incentive Share Purchase Plan (2015-2017) directed towards all employees of the Group at the international level (including executive personnel as well as the Executive Directors), called the “Global Employee Incentive Share Purchase Plan” (“GESPP”), was approved by the shareholders at the Ordinary General Shareholders’ Meeting of the Company held on May 30, 2014.

This Plan is intended to strengthen Telefónica’s nature as a global employer, creating a common remuneration culture throughout the Company, incentivize participation in capital by all employees of the Group, and encourage their motivation and loyalty.

Through this Plan, employees are offered the possibility of acquiring shares of Telefónica, S.A. for a maximum period of twelve months (purchase period), with the Company’s commitment to deliver to the participants therein a certain number of shares free of charge, provided that certain requirements are met. Each employee can allocate a maximum amount of 1,800 euros, and a minimum amount of 300 euros. If the employee remains with the Telefónica Group and maintains the shares for an additional year after the purchase period (vesting period), they will have the right to receive one free share for each share that they have acquired and maintained through the end of the vesting period.

Mr. José María Álvarez-Pallete López, the only Executive Director of the Company as of 31 December 2016, has decided to participate in this Plan with the maximum contribution, i.e., 150 euros monthly, for twelve months. At December 31, 2016, he had acquired a total of 178 shares under this Plan, with such Director having the right to receive an equivalent number of shares free of charge, provided that the shares acquired have been kept for the vesting period (twelve months from the end of the purchase period), among other conditions.

***vi) Termination payments for termination of the relationship***

As of the date of issuance of this Report, no Director of Telefónica, S.A. has received severance payments for the termination of their relationship with the Company.



#### D BREAKDOWN OF INDIVIDUAL REMUNERATION ACCRUED BY EACH OF THE DIRECTORS

<b>NAME</b>	<b>Type</b>	<b>Accrual period – Fiscal year 2016</b>
MR. JOSÉ MARIA ÁLVAREZ-PALLETE LÓPEZ	Executive	01/01/2016 - 31/12/2016
MR. ISIDRO FAINÉ CASAS	Proprietary	01/01/2016 - 31/12/2016
MR. JOSÉ MARIA ABRIL PÉREZ	Proprietary	01/01/2016 - 31/12/2016
MR. JULIO LINARES LÓPEZ	Other external	01/01/2016 - 31/12/2016
MR. CESAR ALIERTA IZUEL	Other external	01/01/2016 - 31/12/2016
MS. MARIA EVA CASTILLO SANZ	Other external	01/01/2016 - 31/12/2016
MR. JUAN IGNACIO CIRAC SASTURAIN	Independent	08/04/2016 - 31/12/2016
MR. JOSÉ JAVIER ECHENIQUE LANDIRIBAR	Independent	08/04/2016 - 31/12/2016
MR. PETER ERSKINE	Independent	01/01/2016 - 31/12/2016
MS. SABINA FLUXÀ THIENEMANN	Independent	08/04/2016 - 31/12/2016
MR. LUIZ FERNANDO FURLÁN	Independent	01/01/2016 - 31/12/2016
MR. GONZALO HINOJOSA FERNÁNDEZ DE ANGULO	Independent	01/01/2016 - 31/12/2016
MR. PABLO ISLA ÁLVAREZ DE TEJERA	Independent	01/01/2016 - 31/12/2016
MR. PETER LÖSCHER	Independent	08/04/2016 - 31/12/2016
MR. ANTONIO MASSANELL LAVILLA	Proprietary	01/01/2016 - 31/12/2016
MR. IGNACIO MORENO MARTÍNEZ	Proprietary	01/01/2016 - 31/12/2016
MR. FRANCISCO JAVIER DE PAZ MANCHO	Independent	01/01/2016 - 31/12/2016
MR. WANG XIAOCHU	Proprietary	01/01/2016 - 31/12/2016
MR. JOSÉ FERNANDO DE ALMANSA MORENO-BARREDA	Other external	01/01/2016 - 08/04/2016
MR. CARLOS COLOMER CASELLAS	Independent	01/01/2016 - 08/04/2016

MR. SANTIAGO FERNÁNDEZ VALBUENA	Executive	<b>01/01/2016 - 08/04/2016</b>
MR. ALFONSO FERRARI HERRERO	Independent	<b>01/01/2016 - 08/04/2016</b>

D.1 Complete the following tables regarding the individualized remuneration of each of the directors (including remuneration for the performance of executive duties) accrued during the fiscal year.

**a) Accrued remuneration at the company covered by this report:**

**i) Cash remuneration (in thousands of €)**

Name	Salary	Fixed remuneration	Attendance fees	Short-term variable remuneration	Long-term variable remuneration	Remuneration for belonging to Committees of the Board	Termination benefits	Other items	Total year 2016	Total year 2015
MR. JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ	1,923	0	0	3,430	0	0	0	6	5,359	5,391
MR. ISIDRO FAINÉ CASAS	0	200	0	0	0	80	0	6	286	290
MR. JOSÉ MARÍA ABRIL PÉREZ	0	200	3	0	0	91	0	0	294	295
MR. JULIO LINARES LÓPEZ	0	200	20	0	0	37	0	0	257	276
MR. CESAR ALIERTA IZUEL	607	539	0	0	0	20	0	1	1,167	6,581
MS. MARÍA EVA CASTILLO SANZ	0	120	20	0	0	34	0	0	174	157
MR. JUAN IGNACIO CIRAC SASTURAIN	0	30	0	0	0	0	0	0	30	0
MR. JOSÉ JAVIER ECHENIQUE LANDIRIBAR	0	90	7	0	0	77	0	0	174	0
MR. PETER ERSKINE	0	120	24	0	0	117	0	0	261	269
MS. SABINA FLUXÀ THIENEMANN	0	90	4	0	0	7	0	0	101	0
MR. LUIZ FERNANDO FURLÁN	0	120	0	0	0	0	0	0	120	120
MR. GONZALO HINOJOSA FERNÁNDEZ DE ANGULO	0	120	28	0	0	143	0	6	297	333
MR. PABLO ISLA ÁLVAREZ DE TEJERA	0	120	5	0	0	11	0	0	136	131
MR. PETER LÖSCHER	0	90	6	0	0	7	0	0	103	0
MR. ANTONIO MASSANELL LAVILLA	0	120	18	0	0	56	0	7	201	208
MR. IGNACIO MORENO MARTÍNEZ	0	120	22	0	0	34	0	0	176	171
MR. FRANCISCO JAVIER DE PAZ MANCHO	0	120	25	0	0	123	0	6	274	253

MR. WANG XIAOCHU	0	120	0	0	0	0	0	0	120	30
MR. CARLOS COLOMER CASELLAS	0	30	14	0	0	37	0	4	85	307
MR. SANTIAGO FERNÁNDEZ VALBUENA	0	0	0	0	0	0	0	0	0	0
MR. ALFONSO FERRARI HERRERO	0	30	17	0	0	40	0	3	90	333
MR. JOSÉ FERNANDO DE ALMANSA MORENO- BARREDA	0	30	8	0	0	8	0	3	49	182

ii) Share-based remuneration systems

<b>JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ</b> Global Employee Incentive Share Purchase Plan (GESP) (2015-2017)												
Date of implementation	Ownership of options at the beginning of fiscal year 2016					Options allocated during fiscal year 2016						
	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period				
20/05/2015	63	63	0.00	1 year (after end of purchase period)	115	115	0.00				1 year (after end of purchase period)	
Conditions: See section A.4.												
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016				
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period	
0	0	0	0.00	0	0	0	0	178	178	0.00	1 year (after end of purchase period)	
Other requirements for exercise: 0												
<b>JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ</b> Performance & Investment Plan ("PIP") 2013												
Date of implementation	Ownership of options at the beginning of fiscal year 2016					Options allocated during fiscal year 2016						
	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period				
01/07/2013	300,000	300,000	10.39	3 years from the date of implementation	0	0	0.00				0	
Conditions: See section A.4.												
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016				
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period	

0	0.00	0	0.00	0	0	0	0	300,000	0	0	0	0
Other requirements for exercise: 0												

<b>JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ</b>												
Performance & Investment Plan ("PIP") 2014												
Date of implementation	Ownership of options at the beginning of fiscal year 2016					Options allocated during fiscal year 2016						
	No. options	Shares affected	Exercise price (€)	Exercise period		No. options	Shares affected	Exercise price (€)	Exercise period			
01/10/2014	300,000	300,000	12.12	3 years from the date of implementation		0	0	0.00	3 years from the date of implementation			
Conditions: See section A.4.												
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016				
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period	
0	0.00	0	0.00	0	0	0	0	300,000	300,000	12.12	3 years from the date of implementation	
Other requirements for exercise: 0												

<b>JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ</b>												
Performance & Investment Plan ("PIP") 2015												
Date of implementation	Ownership of options at the beginning of fiscal year 2016					Options allocated during fiscal year 2016						
	No. options	Shares affected	Exercise price (€)	Exercise period		No. options	Shares affected	Exercise price (€)	Exercise period			
01/10/2015	300,000	300,000	11.80	3 years from the date of implementation		0	0	0	0			
Conditions: See section A.4.												
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016				
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares	Gross profit	No. options	No. options	Shares affected	Exercise price (€)	Exercise period	

					affected	(thousands of €)						
0	0.00	0	0.00	0	0	0	0	300,000	300,000	11.80	3 years from the date of implementation	
Other requirements for exercise: 0												

<b>CESAR ALIERTA IZUEL</b> Global Employee Incentive Share Purchase Plan (GESP) (2015-2017)											
Date of implementation	Ownership of options at the beginning of fiscal year 2016						Options allocated during fiscal year 2016				
	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period			
20/05/2015	63	63	0.00	1 year (after end of purchase period)	115	115	0.00	1 year (after end of purchase period)			
Conditions: See section A.4.											
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016			
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period
0	0.00	0	0.00	0	0	0	0	178	178	0.00	1 year (after end of purchase period)
Other requirements for exercise: 0											

<b>CESAR ALIERTA IZUEL</b> Performance & Investment Plan ("PIP") 2013											
Date of implementation	Ownership of options at the beginning of fiscal year 2016						Options allocated during fiscal year 2016				
	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period			
01/07/2013	506,250	506,250	10.39	3 years from the date of implementation	0	0	0.00	0			
Conditions: See section A.4.											



Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016			
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period
0	0.00	0	0.00	0	0	0	506,250	0	0	0	0
Other requirements for exercise: 0											

CESAR ALIERTA IZUEL Performance & Investment Plan ("PIP") 2014												
Date of implementation	Ownership of options at the beginning of fiscal year 2016					Options allocated during fiscal year 2016						
	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period
01/10/2014	506,250	506,250	12.12	3 years from the date of implementation	0	0	0.00	0	0	0	0	0
Conditions: See section A.4.												
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016				
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period	
0	0.00	0	0.00	0	0	0	0	506,250	506,250	12.12	3 years from the date of implementation	
Other requirements for exercise: 0												

CESAR ALIERTA IZUEL Performance & Investment Plan ("PIP") 2015												
Date of implementation	Ownership of options at the beginning of fiscal year 2016					Options allocated during fiscal year 2016						
	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period	No. options	Shares affected	Exercise price (€)	Exercise period
01/10/2015	506,250	506,250	11.80	3 years from the date of implementation	0	0	0	0	0	0	0	0

Conditions: See section A.4.											
Shares delivered during fiscal year 2016			Options exercised in fiscal year 2016				Options expired and not exercised	Options at fiscal year-end 2016			
No. shares	Price	Amount	Exercise price (€)	No. options	No. shares affected	Gross profit (thousands of €)	No. options	No. options	Shares affected	Exercise price (€)	Exercise period
0	0.00	0	0.00	0	0	0	0	506,250	506,250	11.80	3 years from the date of implementation
Other requirements for exercise: 0											

iii) Long-term savings systems

Name	Contribution for the year by the company (€ thousands)		Amount of accumulated funds (€ thousands)	
	Fiscal Year 2016	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2015
MR. JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ	673	673	7,130	6,367
MR. CESAR ALIERTA IZUEL	45	35,601	54,221	52,295
MS. MARÍA EVA CASTILLO SANZ	0	0	1,019	1,007
MR. JULIO LINARES LÓPEZ	0	0	334	330

iv) Other benefits (in thousands of €)

JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ			
Remuneration in the form of advances, loans			
Interest rate for the transaction		Main features of the transaction	Amounts potentially returned
0.00		None	None
Life insurance premiums		Guarantees given by the company in favor of the Directors	
Fiscal Year 2016	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2015
17	15	None	None

<b>CÉSAR ALIERTA IZUEL</b>					
<b>Remuneration in the form of advances, loans</b>					
<b>Interest rate for the transaction</b>		<b>Main features of the transaction</b>		<b>Amounts potentially returned</b>	
0.00		None		None	
<b>Life insurance premiums</b>		<b>Guarantees given by the company in favor of the Directors</b>			
<b>Fiscal Year 2016</b>	<b>Fiscal Year 2015</b>	<b>Fiscal Year 2016</b>		<b>Fiscal Year 2015</b>	
63	74	None		None	

b) **Remuneration accrued by Directors of the company for belonging to boards at other companies of the group:**

i) **Cash remuneration (in thousands of €)**

Name	Salary	Fixed remuneration	Attendance fees	Short-term variable remuneration	Long-term variable remuneration	Remuneration for belonging to Committees of the Board	Termination benefits	Other items	Total year 2016	Total year 2015
MR. JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ	0	0	0	0	0	0	0	0	0	0
MR. ISIDRO FAINÉ CASAS	0	0	0	0	0	0	0	0	0	0
MR. JOSÉ MARÍA ABRIL PÉREZ	0	0	0	0	0	0	0	0	0	0
MR. JULIO LINARES LÓPEZ	0	0	0	0	0	0	0	30	30	240
MR. CESAR ALIERTA IZUEL	0	0	0	0	0	0	0	0	0	0
MS. MARÍA EVA CASTILLO SANZ	0	60	0	0	0	0	0	0	60	120
MR. JUAN IGNACIO CIRAC SASTURAIN	0	0	0	0	0	0	0	0	0	0
MR. JOSÉ JAVIER ECHENIQUE LANDIRIBAR	0	0	0	0	0	0	0	0	0	0
MR. PETER ERSKINE	0	12	0	0	0	0	0	53	65	0
MS. SABINA FLUXÁ THIENEMANN	0	0	0	0	0	0	0	0	0	0
MR. LUIZ FERNANDO FURLÁN	0	87	0	0	0	0	0	30	117	177
MR. GONZALO HINOJOSA FERNÁNDEZ DE ANGULO	0	19	0	0	0	0	0	30	49	146
MR. PABLO ISLA ÁLVAREZ DE TEJERA	0	0	0	0	0	0	0	0	0	0
MR. PETER LÖSCHER	0	0	0	0	0	0	0	0	0	0
MR. ANTONIO MASSANELL LAVILLA	0	0	0	0	0	0	0	0	0	0
MR. IGNACIO MORENO MARTÍNEZ	0	0	0	0	0	0	0	0	0	0

MR. FRANCISCO JAVIER DE PAZ MANCHO	0	181	0	0	0	0	0	30	211	247
MR. WANG XIAOCHU	0	0	0	0	0	0	0	0	0	0
MR. CARLOS COLOMER CASELLAS	0	0	0	0	0	0	0	0	0	0
MR. SANTIAGO FERNÁNDEZ VALBUENA	319	0	0	0	0	0	0	9	328	2,414
MR. ALFONSO FERRARI HERRERO	0	85	0	0	0	0	0	30	115	196
MR. JOSÉ FERNANDO DE ALMANSA MORENO-BARREDA	0	96	0	0	0	0	0	30	126	259

**ii) Share-based remuneration systems**

**iii) Long-term savings systems**

Name	Contribution for the year by the company (€ thousands)		Amount of accumulated funds (€ thousands)	
	Fiscal Year 2016	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2015
JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ	0	0	150	148
JULIO LINARES LÓPEZ	0	0	295	290

**iv) Other benefits (in thousands of €)**

**c) Summary of remuneration (in thousands of €):**

The summary must include the amounts for all items of remuneration included in this report that have been accrued by the director, in thousands of euros.

In the case of long-term saving systems, include contributions or funding for these types of systems:



Name/Type	Accrued remuneration at the Company				Accrued remuneration at companies of the group				Total		
	Total cash remuneration	Amount of shares provided	Gross profit on options exercised	Total year 2016 company	Total cash remuneration	Amount of shares delivered	Gross profit on options exercised	Total fiscal year 2016 group	Total fiscal year 2016	Total fiscal year 2015	Contribution to savings system during the year
MR. JOSÉ MARÍA ÁLVAREZ-PALLETE LÓPEZ	5,359	0	0	5,359	0	0	0	0	5,359	6,645	673
MR. ISIDRO FAINÉ CASAS	286	0	0	286	0	0	0	0	286	290	0
MR. JOSÉ MARÍA ABRIL PÉREZ	294	0	0	294	0	0	0	0	294	295	0
MR. JULIO LINARES LÓPEZ	257	0	0	257	30	0	0	30	287	643	0
MR. CESAR ALIERTA IZUEL	1,167	0	0	1,167	0	0	0	0	1,167	8,691	45
MS. MARÍA EVA CASTILLO SANZ	174	0	0	174	60	0	0	60	234	277	0
MR. JUAN IGNACIO CIRAC SASTURAIN	30	0	0	30	0	0	0	0	30	0	0
MR. JOSÉ JAVIER ECHENIQUE LANDIRÍBAR	174	0	0	174	0	0	0	0	174	0	0
MR. PETER ERSKINE	261	0	0	261	65	0	0	65	326	269	0
MS. SABINA FLUXÀ THIENEMANN	101	0	0	101	0	0	0	0	101	0	0
MR. LUIZ FERNANDO FURLÁN	120	0	0	120	117	0	0	117	237	297	0
MR. GONZALO HINOJOSA FERNÁNDEZ DE ANGULO	297	0	0	297	49	0	0	49	346	479	0
MR. PABLO ISLA ÁLVAREZ DE TEJERA	136	0	0	136	0	0	0	0	136	131	0
MR. PETER LÖSCHER	103	0	0	103	0	0	0	0	103	0	0
MR. ANTONIO MASSANELL LAVILLA	201	0	0	201	0	0	0	0	201	208	0
MR. IGNACIO MORENO MARTÍNEZ	176	0	0	176	0	0	0	0	176	171	0
MR. FRANCISCO JAVIER DE PAZ MANCHO	274	0	0	274	211	0	0	211	485	500	0
MR. WANG XIAOCHU	120	0	0	120	0	0	0	0	120	30	0

MR. CARLOS COLOMER CASELLAS	85	0	0	85	0	0	0	0	85	307	0
MR. SANTIAGO FERNÁNDEZ VALBUENA	0	0	0	0	328	0	0	328	328	3,318	0
MR. ALFONSO FERRARI HERRERO	90	0	0	90	115	0	0	115	205	529	0
MR. JOSÉ FERNANDO DE ALMANSA MORENO- BARREDA	49	0	0	49	126	0	0	126	175	441	0
<b>TOTAL</b>	<b>9,754</b>	<b>0</b>	<b>0</b>	<b>9,754</b>	<b>1.101</b>	<b>0</b>	<b>0</b>	<b>1.101</b>	<b>10,855</b>	<b>23,521</b>	<b>718</b>

## **D.2 Report the relationship between remuneration obtained by the directors and the results or other measures of the entity's performance, explaining how any changes in the company's performance may have influenced changes in the remuneration of the directors.**

### **D.2.1. Annual variable remuneration**

During the evaluation carried out by the Nominating, Compensation and Corporate Governance Committee based on the audited results for all of fiscal year 2016, the following measures of performance and weightings were taken into account:

- Quantitative objectives:
  - 30% Operating Income Before Depreciation and Amortization (OIBDA): with a level of achievement assessed at 99.3%.
  - 30% Operating Revenue: with a level of achievement assessed at 96.8%.
  - 20% Free Cash Flow, with a level of achievement assessed at 109.5%.
  
- Qualitative objectives:
  - 20% Qualitative objectives, represented by the level of satisfaction of the Group's customers. The Audit and Control Committee has measured this objective using two indicators according to the standard criteria applicable to such indices, and considered to have remained slightly below targets.

Following the evaluation of achievement of the aforementioned objectives, the Nominating, Compensation and Corporate Governance Committee has established the overall achievement of objectives at 99.1%. Therefore, the annual variable remuneration level is set at 79.28% of the maximum.

### **D.2.2. Medium/long-term variable remuneration**

2016 saw the conclusion of the third cycle of the first PIP, which began in 2013. In order to determine the specific number of shares to be delivered at the end of such cycle, Kepler provided to the Nominating, Compensation and Corporate Governance Committee the results of Telefónica's Total Shareholder Return ("TSR") compared to this same metric at the companies included in the Dow Jones Global Sector Titans Telecommunications Index during the same period.

Telefónica's TSR ended below the median according to the established scale of achievement. Therefore, the Participants in the third cycle of the first PIP, which includes the Executive Directors, were not entitled to receive any of the shares allotted in 2013.

## **D.3 Report the results of the consultative vote of the shareholders on the annual remuneration report for the preceding fiscal year, indicating the number of votes against, if any:**

	Number	% of total
Votes cast	2,792,643,792	56.13%

  

	Number	% of total
Votes against	116,921,556	4.19%
Votes in favor	2,530,707,271	90.62%
Abstentions	145,014,965	5.19%

## **E OTHER INFORMATION OF INTEREST**

**If there are any significant aspects regarding director remuneration that could not be included in the other sections of this report, but should be included in order to provide more complete and well-reasoned information regarding the remuneration structure and practices of the company with respect to its directors, briefly describe them.**

On April 8, 2016, Mr. César Alierta Izuel, until then the Executive Chairman of Telefónica, S.A., ceased to perform executive duties within the Telefónica Group, changing his nature from Executive Director to Other External Director.

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**This annual remuneration report was approved by the board of directors of the company at its meeting of February 22, 2017.**

**State whether any directors voted against or abstained in connection with the approval of this Report.**

**No**

Individual or company name of the director that did not vote in favor of the approval of this report	Reasons (opposed, abstained, absent)	Explain the reasons