4

Business
Principle model_

Megatrends, opportunities and strategy_

We find ourselves in a world in constant movement and evolution, where borders are becoming more and more blurred. Phenomena such as climate change and immigration, together with the economy, education and health, are nowadays more global than ever. What was yesterday's future is today's reality.

Technological transformation is present in all areas of our lives. Connectivity and digitisation have transformed both society and the economy, becoming two essential and differentiating elements in a world which is increasingly global, open and digital.

It is precisely in this context that we can identify six tightly connected megatrends set to change our lives and influence the different industrial sectors over the coming years. Such trends will be boosted by technology, which will play an essential role. The growing use of mobile devices, along with the proliferation of data and digital transformation, are some of the keys to the change in market behaviour in most industries. New technologies are acting transversely on society, the economy and our daily lives, driving change.

The digital future, the rise in innovation and the global nature of the market are having a profound impact on economies. Moreover, some of the trends pose a significant challenge to business sustainability, such as the urbanisation

1. Digital future: Digitisation is changing the economy, providing new challenges and opportunities.

2. Innovation: Highlights the need to support open innovation ecosystems.

3. Global market: New patterns of trade and investment are being created.

4. Urban world: Its expansion necessitates sustainable planning of the cities of the future.

5. Finite resources: Growing demand is boosting innovation in this area.

6. Transformation of the traditional sectors: New technologies are transforming the traditional sectors of the economy.

|||||| More interactive
.... Less interactive

of the planet, the shortage of raw materials and the transformation of the traditional industries.

However, we must bear in mind that nowadays we no longer seek to simply make companies sustainable, but to meet the basic needs of society as well and to face the environmental,

technological or social long term emerging risks. A good example of this is the 2030 Agenda for sustainable development, which contains 17 objectives. New technologies will be key in reaching these objectives as they provide not only a vehicle for progress but also the tools needed to overcome the challenges.

The technology sector continues to gain market share in world GDP and as such means technology plays an ever more important role in people's lives, allowing them access to products and services that promote greater efficiency and boost economic and social development processes. Connectivity thus take on a higher

relevance and, generally speaking, gives rise to three major trends, based on the three types of convergence that our customers demand:

▶ Fixed + Mobile Convergence: Our customers seek comprehensive solutions which meet all their connectivity needs - at home, in the office and when they are on the move. This translates into increased investment in infrastructures and the proliferation of 4-Play packages.

▶ Convergence between Telecommunications, Internet and Media: Content is offered through applications that are supported by our networks. More specifically, video consumption is already becoming the application with the greatest traffic demand, making it a key element of the commercial packages we sell.

▶ Convergence between Networks and IT: Cloud technology is beginning to allow the virtualisation of network functions to improve efficiency and operational flexibility. This allows us to evolve towards new network architectures which are more software intensive. This is a competitive advantage, as it favours groups with scale, like us, which are capable of extracting synergies from different local operators.

Moreover, the barriers preventing entry into the market are being eliminated. As a result,

boundaries between products and services are disappearing while their life cycles are shortening, increasing customer expectations.

Social development will be exponential as a result of the digital revolution. A new world of opportunities is opening up for everyone, everywhere. A better world, a world to discover, which we will all benefit from and share.

Connectivity is essential in this new era. If we look around, we can see that the world in which we live is defined by one concept: connections. Supported by technology and open to multiple possibilities and applications. In a world in which everyone and everything will be connected, with excellent connectivity; the services of the future are unlimited.

FURTHER INFORMATION

Watch the video "Telefónica is an Onlife Telco: Connectivity is in our DNA".

Desde cualquier dispositivo, estés donde estés
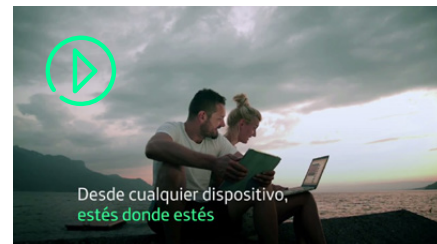
For Telefónica it is an opportunity to facilitate these connections through connectivity, allowing people to take control of their digital lives by making the data available to them.

BUSINESS STRATEGY

Our strategic plan includes six key elements. Three main objectives - excellent connectivity, a comprehensive offer, and customer values and experience; and three enablers - Big Data and innovation, end-to-end digitisation and allocation of capital and simplification, are our tools for transforming the Company.

Excellent connectivity

Big Data and innovation

Comprehensive offer

E2E digitisation

Customer values and experience

Allocation of capital and simplification

VALUE PROPOSITION

ENABLERS

We want to create, protect and promote life connections so that people can choose a world of infinite possibilities

Excellent connectivity:

In an era of exponential growth of apps, services and terminals, we must make the most of the infrastructures which differentiate us from our competitors, providing the best customer experience and investing to ensure excellent connectivity. This is what our customers expect of us, and won't settle for anything less.

People want to be permanently connected, anywhere they are, regardless of the device and with the highest quality. As a result of the efforts made in recent years to transform our networks and operational support and business systems, at Telefónica our focus is on meeting the expectations of our customers.

Comprehensive offer:

Our aim is to facilitate our customers' digital lives by means of the best products, services and contents, through a simple and comprehensive offer which is attractive and easy to understand.

We are in a privileged position due to our distinctive assets and our capacity to deliver (knowledge of the customer, value proposition, global scope, network of partners, innovation ecosystem and internal transformation experience). Our comprehensive offer consists of a wide range of products and services which anticipate and adapt to the needs of our customers, thanks to personalised proposals for both individuals and companies.

Customer values and experience:

Connectivity and supply are not sufficient if they are not accompanied by a distinctive experience which strengthens our brand values and defends the interests of our customers, placing them at the centre of our business. We want them to be increasingly more satisfied as a result of a unique experience at a transactional and emotional level.

We are committed to digital trust, giving customers control of their digital lives, an open Internet in which everyone is free to choose their digital experience, and digital accessibility, ensuring everyone enters digital life with the best technology, without neglecting anyone.

Big Data and Innovation:

After highlighting connectivity, we are taking a further step forward and granting added value to data in order to provide our customers with the services most suited to their needs. Big Data is the key not only to knowing them better, but also to optimising our resources and operations.

We are transforming ourselves into a new Company, providing our customers with control over their own data so that they may decide how to live their digital lives.

We also promote internal innovation (which is in our DNA), external innovation and entrepreneurship to develop sustainable services which have a positive impact on our society.

End-to-End Digitisation:

Our value chain must be fully digital to become a real-time, automated and convergent Company. Every aspect of the business must be digital: the automation of all customer processes and experience, data collection and the ability to offer a differential value proposition. Digitisation is no longer a possibility - it's a reality.

The transformation of our processes, policies and systems is the cornerstone of digitisation, as well as being a facilitator of other priorities.

Allocation of capital and simplification:

Optimal allocation of resources allows us to continue moving forward in our transformation, financing growth, eliminating complexities and reaching our goals. Our vision is very ambitious and requires continuous capital investment to increase our capabilities.

Therefore, we have two basic financial goals:

▶ Profitable growth optimising the allocation of capital: have the best portfolio of assets, execution of synergies and optimisation of investment and simplification.

▶ Meeting financial commitments: a solid balance sheet, profitability for the shareholders and financial flexibility.

At Telefónica we are choosing to grow: to grow profitably while maintaining financial flexibility and generating value.

Relationships with our stakeholders_

Direct interaction with our stakeholders is essential for the management of our Company. This relationship allows us to identify which aspects they consider most relevant, as well as new trends in the field of sustainability. Based on this dialogue, we establish our goals, define the strategic plan and also assess our ability to meet society's expectations.

STAKEHOLDER DIALOGUE STRATEGY

Objective: To focus our actions on the real needs and expectations of our stakeholders, **allowing sustainability and business to align.**

1. Selection of our key stakeholders.
2. Definition of engagement model:
▸ Specialised dialogue
▸ Periodical monitoring
▸ Collaboration for common challenges.
3. Identification of differences in perception and performance.
4. Action assessment.

Stakeholder management

Business goals

Map of stakeholders
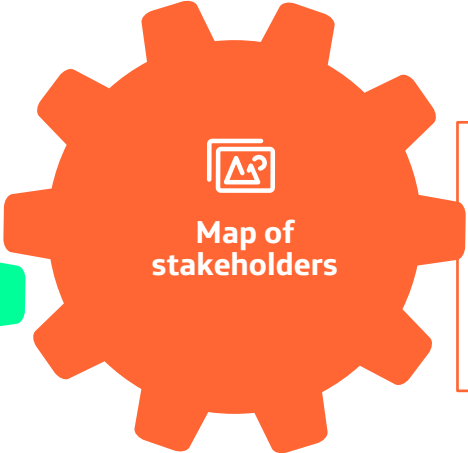
1. Global map.
2. Identification of material aspects.
3. Prioritisation of key stakeholders.

1. Identification of key material issues for the business.
2. Identification of internal partners and external engagement.
3. Establishment of objectives and lines of action to achieve these objectives.

DIALOGUE, COMMITMENT AND INTERACTION BETWEEN TELEFÓNICA AND ITS STAKEHOLDERS

Customers

Methodology: Through the channels of dialogue set up at the moment of sale and as a result of customer services, satisfaction monitoring services and the Customer Defence Service (CDS), as well as marketing and market studies, discussion forums and meeting areas, we can understand the consumer experience, needs and expectations for our products and services.

Some examples of commitment and interaction with customers:

▸ For residential customers we have customer service channels in each of our geographical areas (which received 377,000 inquiries in 2015) and the "Guru" services, as well as our profiles on Twitter (Telefónica on Twitter, Movistar on Twitter, among others).

▸ In the field of large corporate and multinational clients, in addition to our Business Solutions division, particularly worthy of mention are the TBS Quality Week, the Telefónica Leadership Conference, as well as other events such as International Telecoms Week.

This year is also particularly relevant due to the active participation of our customers in the definition of our new "Choose It All" Company Programme. For nearly two years we interviewed more than 3,000 consumers in 12 countries and performed about 72 focus groups to address those aspects which are most important for our customers. This work has helped us to define the new Company strategy.

Employees

Methodology: We promote the use of the internal Yammer Network, which has 89,000 members (14,000 users more than last year) and an average of 550 active communities per month on the Company network, as both a communication and an inquiry tool.

This Network has been a key tool for facilitating dialogue and debate prior to the launch of the new Company programme. The event was followed via Yammer by more than 4,000 people.

Best practices: During the executives' summit in 2015, Twitter played a special role among our employees, with about 2,000 people "liking" the messages posted; in addition, the #Modoencuentro hashtag became a trending topic on Twitter in Spain, despite competition from other trends such as the Spanish electoral debate and football's Ballon d'Or award.

Shareholders

Methodology: We organise and attend regular meetings, both individual and collective, with institutional investors and sectoral analysts. Moreover, thanks to the online channels we can understand which issues are most relevant to the investment community, including SRI (Socially Responsible Investment) Institutions and/or specific projects for responsible investment and signatories of the Responsible Investment Principles.

Some examples of commitment and interaction: Telefónica Shareholders and Investors, Forums and events for Shareholders and Investors, European Sustainable Investment Forum (Eurosif), Société Generale, RobecoSam, Integrated Reporting.

Suppliers

Methodology: The purchasing area maintains an ongoing dialogue with our main suppliers, promoting the search for joint solutions in partnership with each of the internal areas which demand the product and/or service. Supplier involvement is key, especially in processes where contact with our customers is performed directly by our suppliers. One example of this is the case of technical and commercial support services, about 80% of which is provided by suppliers in many countries.

Some examples of commitment and interaction:

▸ The Allies (Aliados) programme, implemented in our main operations in Latin America.

▸ Meetings with some of our main suppliers at a global level to share our strategies on sustainability issues and to exchange best practices.

▸ Workshops on Energy and Climate Change, organised annually by Telefónica and attended by some of our main suppliers.

Sectoral organisations

Methodology: We actively participate in forums and associations which discuss the different issues affecting our sector, in order to improve measurements, standardise indicators and share best experiences.

Some examples of commitment and interaction: GSMA, International Telecommunications Union (ITU), ASIET, Global e-Sustainability Initiative, European Internet Forum, Telecommunications Industry Dialogue, ICT Coalition, Internet Governance Forum, Global Reporting Initiative, CSR Europe and RSE Action.

International organisations

Methodology: The dialogue is mainly structured by geographical areas, grouping together the different participants according to their sphere of action (local, regional, national and global). Within each field of activity we maintain a fluid dialogue with those responsible for telecommunications, innovation and consumer, educational, social, regulatory and economic services, etc.

Some examples of commitment and interaction: World Economic Forum, International Labour Organization, World Health Organization, United Nations Programme for Development, Global Compact, Carbon Disclosure Project and the Centre for Information Policy Leadership.
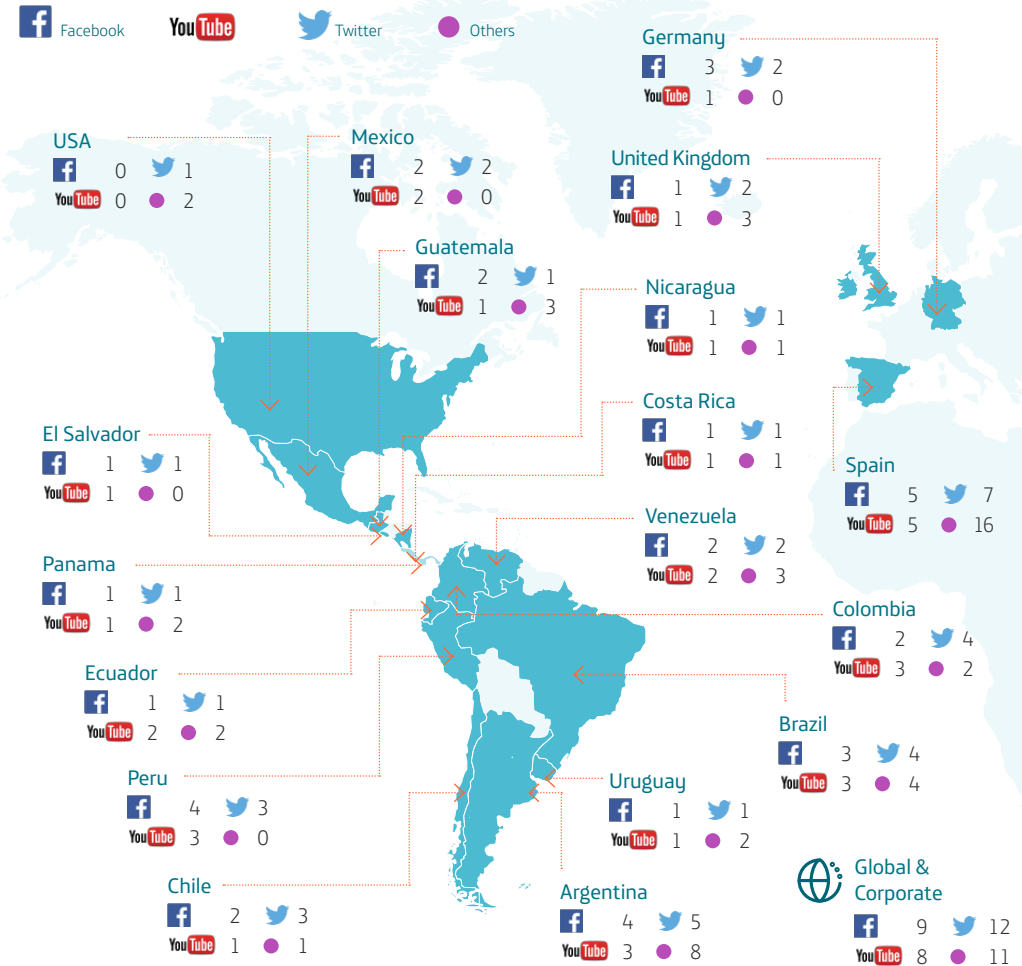
Non-governmental organisations

Methodology: We articulate the dialogue principally at a local level in order to respond to the needs of the communities in which we operate. In the case of Spain, we collaborate with more than 25 NGOs by means of the Premium messaging service, giving the NGO 100% of the money donated by the customers give through solidarity SMSs. Dialogue with these organisations is ongoing.

Some examples of commitment and interaction: NCE - ILUNION Foundation, Red Cross, UNICEF, Oxfam Intermón, International Plan, ACNUR, Spanish Committee of Representatives of People with Disabilities (CERMI), National Centre of Accessibility Technologies (CENTAC).

TELEFÓNICA'S SOCIAL NETWORK CHANNELS

Facebook   YouTube   Twitter   Others

Germany
Facebook 3   Twitter 2
YouTube 1   Others 0

USA
Facebook 0   Twitter 1
YouTube 0   Others 2

Mexico
Facebook 2   Twitter 2
YouTube 2   Others 0

United Kingdom
Facebook 1   Twitter 2
YouTube 1   Others 3

Guatemala
Facebook 2   Twitter 1
YouTube 1   Others 3

Nicaragua
Facebook 1   Twitter 1
YouTube 1   Others 1

El Salvador
Facebook 1   Twitter 1
YouTube 1   Others 0

Costa Rica
Facebook 1   Twitter 1
YouTube 1   Others 1

Spain
Facebook 5   Twitter 7
YouTube 5   Others 16

Panama
Facebook 1   Twitter 1
YouTube 1   Others 2

Venezuela
Facebook 2   Twitter 2
YouTube 2   Others 3

Colombia
Facebook 2   Twitter 4
YouTube 3   Others 2

Ecuador
Facebook 1   Twitter 1
YouTube 2   Others 2

Brazil
Facebook 3   Twitter 4
YouTube 3   Others 4

Peru
Facebook 4   Twitter 3
YouTube 3   Others 0

Uruguay
Facebook 1   Twitter 1
YouTube 1   Others 2

Chile
Facebook 2   Twitter 3
YouTube 1   Others 1

Argentina
Facebook 4   Twitter 5
YouTube 3   Others 8

Global & Corporate
Facebook 9   Twitter 12
YouTube 8   Others 11

Keeping our stakeholders informed and engaged in dialogue forms one of our goals of the 2.0 environment. During 2015 we worked on the integration of the new corporate website – www.telefonica.com, which received 3,215,347 visits last year, in order to concentrate all Company information in a single portal. In this sense, we have also worked to simplify social network and blog channels in order to respond more effectively to customer concerns and the latest technology trends.

SOME OF THE ASSOCIATIONS WITH WHICH TELEFÓNICA COLLABORATES

AENOR, a Spanish entity that conducts normalisation and certification (N+C) activities to improve quality in companies and the well-being of society.

An Association made up of more 50 telecommunications operators in 20 countries across Latin America and Spain.

Business Call to Action aims to accelerate progress towards the Millennium Development Goals (MDGs).

The CEOE is the institution that represents Spanish entrepreneurs.

The Centre was built with one fundamental objective: to become a technical reference in the analysis of youth phenomena.

The CITEL is the advisory body of the Organization of American States in matters relating to telecommunications/ICT.

The State Confederation of Deaf People is a not-for-profit, state-level social action NGO.

The European Commission is the institution which embodies the executive branch of community power.

CAF is a development bank made up of 19 countries and 14 private banks in the region.

A significant group of leading Spanish companies, Corporate Excellence aspires to become a technical benchmark.

CSR Europe is an international network of companies which heads the promotion of Corporate Social Responsibility in Europe.

EcoVadis aims to improve companies' environmental and social practices.

ERT is an informal forum which brings together up to 50 managing directors and chairmen of major multinational companies of European parentage.

ETNO is the association which encompasses the major European operators.

ETSI, the European Telecommunications Standards Institute.

4G Americas is a commercial wireless industry association focused on the Americas.

The Global Apprenticeships Network (GAN) is a business partnership driven by the overarching objective of promoting and linking entrepreneurial initiatives to skills and employment opportunities for young people.

The Global e-Sustainability Initiative (GeSI) is a source of information on resources and best practices to achieve integrated social and environmental sustainability through Information and Communications Technology (ICT) companies.

The The United Nations Global Compact is an international initiative which promotes the implementation of ten universally accepted principles in the areas of Human Rights, Labour Standards, the Environment and the Fight against Corruption.

The Global Network Initiative (GNI) is a non-governmental organisation for Internet censorship by authoritarian governments and the protection of privacy on the Internet and the rights of individuals.

Global Reporting Initiative (GRI) is an organisation whose purpose is to promote the development of sustainability reports in all types of organisations.

The GSMA represents the interests of mobile operators worldwide.

The IADB supports efforts in Latin America and the Caribbean to reduce poverty and inequality.

The International Integrated Reporting Council (IIRC) is a joint global initiative of regulators, investors, companies, issuers of accounting standards and professional accouting organisations.

The ITU (International Telecommunications Union) is the United Nations' specialised agency for Information and Communication Technology (ICT).

The United Nations is an international organisation founded by 51 countries committed to maintaining international peace and security and promoting social progress, better living standards and Human Rights.

The aim of the OECD is to promote policies which improve the economic and social well-being of people around the world.

An organisation devoted to the social and labour inclusion of people with disabilities.

The World Bank is a vital source of financial and technical assistance for developing countries around the world.

The World Economic Forum is an international institution dedicated to improving the situation around the world by means of public-private cooperation.

Telefónica participates in sustainability issues alongside Local Associations in all the markets in which it operates, for example: Pantallas Amigas, SPAINSIF...

Materiality analysis_

Thanks to the relationship with our stakeholders we are able to align sustainability and business. That allows us to identify which matters we must address, understand the perception of the Company and determine to what extent we are meeting expectations. This allows us to guide ourselves towards what is really important to them, thereby facilitating transparency.

We start with a materiality analysis, which is specific to the entire value chain of the new technologies hypersector and is designed by the Global e-Sustainability Initiative (GeSI). The analysis preselects 55 potentially material issues which are divided into eight categories: digital inclusion, employees, climate change, supply chain, customers, privacy, governance and impact on communities. We call on all stakeholders related to the Company to help us preselect these material points which have key impacts on our activity.

The stakeholders which have took part in the GeSI project are: Alcatel-Lucent, Amdocs, AT&T, Bell, Bkash, Bolo Phi, Bosch, BSR, BT, Calvert, Deutsche Telekom, Ericsson, ETNO, Everything Everywhere, Forum for the Future, Green Electronics Council, Greenpeace, GSMA, HP, Huawei, Institute for Public and Environmental Affairs (IPE), Institute of Contemporary Observation (ICO), ITU, KPN, Nokia, OTE,

SPECIALISED DIALOGUE: SUSTAINABILITY ADVISORY PANEL

Independent group of experts who:

▶ **Represent our main stakeholders.**

▶ Provide **an external and independent point of view in matters of sustainability**.

Dual purpose:

▶ **Give tangible expression to stakeholder expectations** through a structured dialogue process.

▶ **Activate** key stipulated aspects to be found in our materiality matrix and annual recommendations.

Process   2016

Identification of the critical opinions of stakeholders

Sustainability Advisory Panel

20 key talking points (Quarterly meetings)

Extended panel

Up to 100 additional critical talking points (Biannual consultations)

Materiality analysis

▶ Identification of relevant aspects

▶ Links with departments and activities

▶ Country revision

Results

▶ Dialogue platform.

▶ Structured process and contributions to our materiality analysis.

▶ Quarterly reports.

▶ Biannual global pulse.

▶ Annual Report: recommendations and trends.

SACOM, SAM Robeco, SASB, Seagate Technology, Skyworks Solutions Inc., Solving the e-Waste Problem (StEP), Sony Mobile, Sprint, Swisscom, TDC Group, Telecom Italia, Telefónica, Telenor, TeliaSonera, Telstra, The Consultative Group to Assist the Poor (CGAP), The Energy and Resources Institute (TERI), The Sustainability Consortium, United Nations University, Verizon, VimpelCom, Vodafone, World Resources Forum and WWF.

The results of analysis, together with our Company strategy, have given way to our materiality matrix.

Towards the end of 2015, in order to keep the matrix up to date, we assumed the challenge of performing a continuous 360° dialogue exercise with our key stakeholders. For this purpose we have approved the creation of a stakeholder panel as a platform for formal and structured dialogue. Thus, we have created a Sustainability Advisory Panel and a broader advisory group, which will become operational in 2016. Both of these will be made up of experts in social, innovation and environmental matters and will be consulted on a regular basis. In addition, this will allow our stakeholders to interact with each other in a structured manner, facilitating the monitoring of common challenges.

SOCIAL RESPONSIBILITY ISSUES

		Supply chain	Internal processes	Customers
Economic issues	Quality of service			
	Digital trust			
	Ethical business practices			X
	Impact on communities			
	Transparency in fiscal contributions	X		X
Environmental issues	Energy consumption			
	Carbon emissions			
	Circular economy			
	Renewable energy	X		X
	Electromagnetic fields	X		
Social issues	Occupational health and safety			X
	Social innovation (digital inclusion)	X		
	Talent development and retention	X		X
	Diversity and non-discrimination			
	Human rights			

▶ Very high priority　　▶ High priority　　▶ Medium priority　　X Not applicable

These panels will discuss relevant issues at a global and local level, paying particular attention to the most significant markets such as Spain, Brazil, Mexico, Germany and Chile.

This panel has been made possible thanks to more than 25 interviews with Group senior executives and the realization of more than 1,500 online surveys in key markets.

FURTHER INFORMATION
Refer to the "Stakeholder Engagement" section of our corporate website.

Reputation management_

Reputation has become a strategic asset for companies. It attracts and increases the loyalty of the best customers, employees and resources, while also reinforcing the character and corporate identity of a company. Thanks to reputation, we can measure whether a company is capable of aligning its external perception with its internal reality.

We understand reputation to be the opinion that Stakeholders have of Telefónica, and that it therefore belongs exclusively to them, even though it is bound to our activity.

Given the importance of reputation and its impact on the business, since 2005 we have been measuring it by means of the RepTrak model, developed by the Reputation Institute, which has become a sectoral reference model as a result of the studies conducted by the GSMA.

This model measures the emotional appeal of our Company by means of the RepTrak Pulse indicator, which is built on the values of esteem, admiration, trust and impression generated. This measurement is complemented by a more rational assessment of performance, using the RepTrak Index indicator. The rational indicator, in the case of the General Public, is built on seven dimensions: Offer, Work, Government, Leadership, Innovation, Citizenship and Finances.

Reputation is an emotional attachment that allows us to analyse how inner reality and external perception are aligned. It has a strong relationship with…

ESTEEM — ADMIRATION — TRUST — IMPRESSION

RepTrak™ Deep Dive
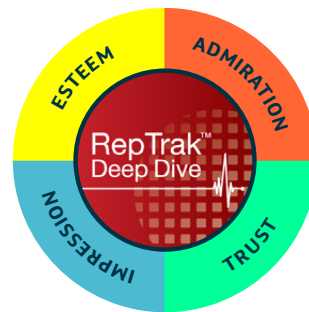
▶ Who **uses** the company products?

▶ Who **recommends** the company?

▶ Who is **willing to invest** in it?

▶ Who grants the **benefit of the doubt**?

▶ Who **wants to work** for the company?

▶ How are the strategy and the results **aligned**?

TO WHAT EXTENT A GOOD REPUTATION INFLUENCES THE SUPPORT OF STAKEHOLDERS

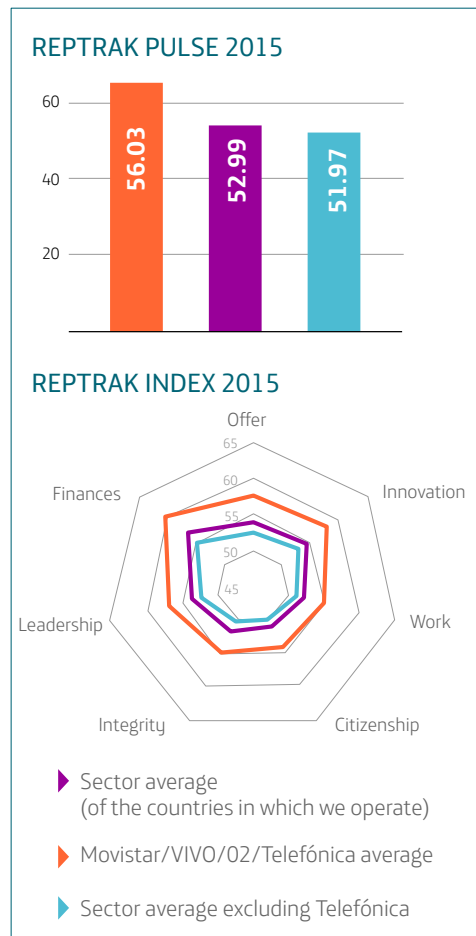Companies with a good or excellent reputation enjoy greater public support

Scores: Reputation Institute – Global RepTrak® 100 – 2015.

Behaviours	Poor 0-39	Weak 40-59	Medium 60-69	Strong 70-79	Excellent 80+
Would buy the products	8%	21%	41%	65%	90%
Would recommend the Company	6%	18%	38%	63%	90%
Would say something positive	6%	18%	40%	66%	91%
Would work for	6%	13%	26%	43%	82%
Would invest in	5%	12%	24%	42%	82%
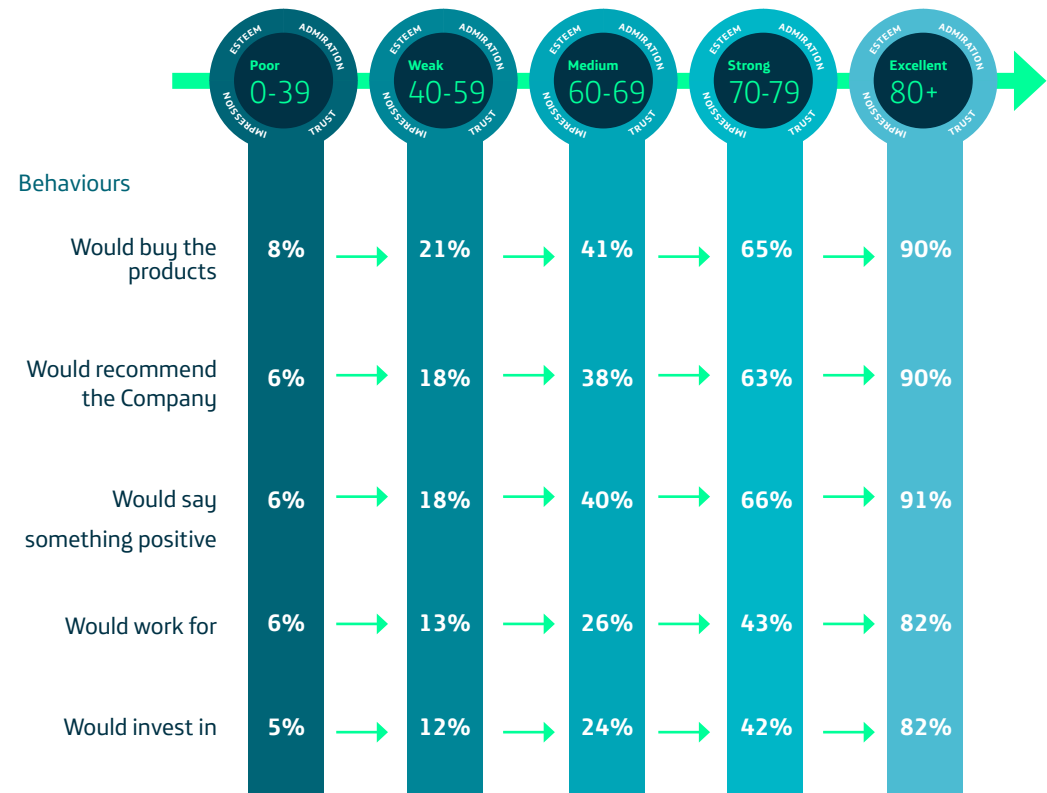
Details of the evaluation of our brand names during 2015 for each of the dimensions are shown in the following graph:

GENERAL PUBLIC REPUTATION

REPTRAK PULSE 2015

56.03	52.99	51.97

REPTRAK INDEX 2015

Offer
Innovation
Work
Citizenship
Integrity
Leadership
Finances

▶ Sector average
(of the countries in which we operate)

▶ Movistar/VIVO/02/Telefónica average

▶ Sector average excluding Telefónica

Similarly, the role of employees as the definers of organisational identity and the recipients of corporate action is essential to the construction of the corporate reputation.

It is for the above reason that, since 2013, we have measured Telefónica's reputation among our employees in the 16 countries in which we operate. The aspects which were evaluated include: Ethical behaviour, Motivation, Professional development and Work environment.

REPUTATION OF TELEFÓNICA AMONG ITS EMPLOYEES

2013	2014	2015
79.7	80.4	83.3
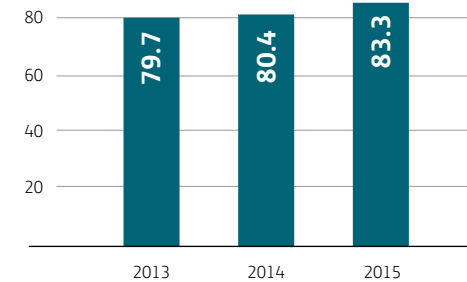
Telefónica's reputation among our employees is very solid and has improved for a second consecutive year.

We are convinced that our reputation influences the attitudes of our stakeholders towards the Group brands. For this reason we work to measure, progressively, the influence of our reputation among those stakeholders most relevant to our activity:

MEASUREMENT OF REPUTATION AMONG KEY STAKEHOLDERS

▶ GENERAL PUBLIC (Annual)

▶ B2B (2016)

ESTEEM
ADMIRATION
RepTrak® Pulse
TRUST
IMPRESSION

▶ EMPLOYEES (Annual)

▶ SUPPLIERS (Biannual)
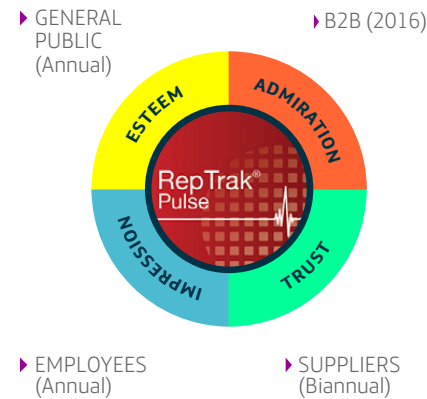
These studies are conducted in all the markets in which we operate and allow us to interact with more than 120,000 people, employees and general public alike.

Pursuing alignment of our internal reality and our external perception, we analyse the impact of our actions and communications on the perceptions of our stakeholders and their associated behaviours. This is essential for charting a roadmap from management to communication.

WE LINK REPUTATION TO RESULTS

DRIVERS → RESULTS

Act and communicate → Perceptions → Behaviours

Act
Experience
Attitudes towards the service

Communicate
Reputation

Brand

Risk management_

Risks are inherent to all businesses and entrepreneurial activities. Their identification and effective assurance contribute to achieving our business objectives and to strengthening the organisation's commitment to its shareholders, customers and other stakeholders.

At Telefónica we have implemented a homogeneous model throughout the Group's main operations, so that the Company's managers, within their scope of action, can perform the appropriate identification, assessment, response to and monitoring of the main risks.

Through the Integrated Model for risk assurance and management, inspired by best practices, we facilitate the prioritisation and development of coordinated initiatives to combat risks, both from a global perspective and with a specific focus on the Group's main operations.

PRIORITISATION AND ACTION IN RESPONSE TO RISKS
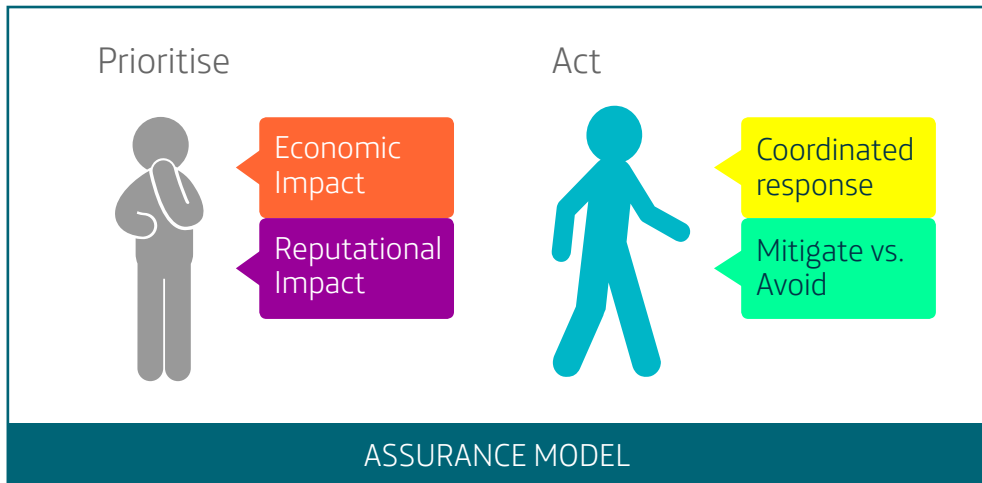
THE TELEFÓNICA RISK MANAGEMENT MODEL

We constantly monitor the most significant risks and long term emerging risks that could affect the main companies in the Group. For this purpose, the Company has established a Corporate Model of Risk Management based on COSO (Committee of Sponsoring Organisations of the Treadway Commission), which facilitates assessment of both the impact and the probability of occurrence of the various risks.

In accordance with this Model and on the basis of internationally renowned references and practices regarding risk management, four risk categories have been defined:

▶ **Business**: potential losses in value or results arising from changes to the business environment, the competition and market situation, changes to the regulatory framework or strategic uncertainty.

▶ **Operational**: potential losses in value or results arising from events caused by inadequacies or failures in customer service, processes, human resources, hardware and computer systems, security, contract fulfilment, laws and standards, or external factors.

▶ **Financial**: potential losses in value or results arising from adverse movements of financial variables and the Company's inability to honour its commitments or liquidate its assets. Risks of a fiscal nature are also included in this category.

▶ **Global**: potential losses in value or results arising from events transversely affecting the Telefónica Group, its reputation and corporate responsibility, corporate communication, the advertising strategy, the brand, sponsorships and innovation.

RISK MANAGEMENT PROCESS

RISK MANAGEMENT GOVERNANCE

The Audit and Control Committee, as part of Telefónica's Board of Directors, oversees the risk management system and proposes to the Board of Directors, for its analysis and consideration, the risk control and management policy, which determines: the risk categories faced by the Company; the definition of an acceptable risk level; the measures for mitigating the impact of identified risks; the control and information systems which will control and manage said risks.

In accordance with the risk management policy, each management area participates in the risk management process, at both corporate and local levels. The entire organisation has the responsibility to contribute to the identification and management of risk, using procedures which develop the operation and assurance of its processes within the Group.

With regard to the coordination and reporting of these activities, there exists an internal Risk Management function within the Internal Audit unit which reports functionally to the Audit and Control Committee.

FLOW OF RISK REPORTING

Corporate level

Corporate function of risk management

Local function of risk management

Local level

Risk owners
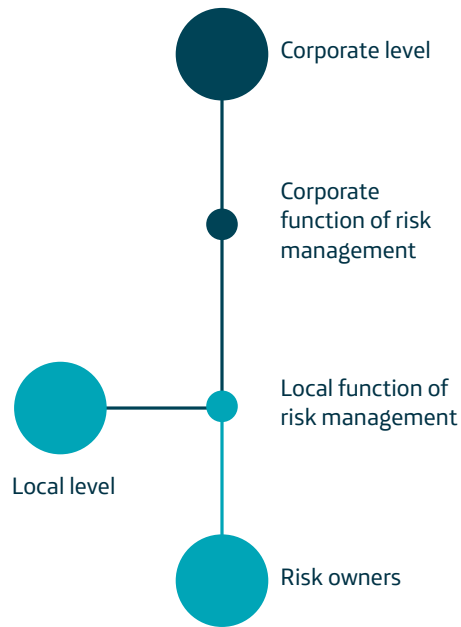
RISKS AND UNCERTAINTIES FACED BY THE COMPANY

The Telefónica Group's business is conditioned both by factors exclusive to the Group as well as by factors which are common to any company in its sector. The most significant risks and uncertainties facing our Company, and which might affect our business, financial situation, reputation, corporate image, brand and results

are presented together with the information contained in the Management Report of the Financial Statements, the details of which can be found in the annex of the Financial Report:

▶ The deterioration of the economic or political environment may adversely affect Telefónica's business.

▶ The Group's results and financial situation may be affected if we do not effectively manage our exposure to the exchange rates of foreign currencies, interest rates and financial risks arising from investments.

▶ The current conditions or the deterioration of the financial markets may limit the Group's financing capacity and, consequently, its ability to carry out the business plan.

▶ The purchase of Telefónica's operations in the United Kingdom (O2 UK) by the Hutchison Whampoa Group may not materialize.

▶ The Company operates in a heavily regulated industry which requires certified authorisation for the provision of many of its services and the use of the spectrum, which is a scarce and expensive resource.

▶ The Telefónica Group is exposed to risks regarding compliance with legislation against corruption and economic sanction programmes.

▶ The customers' perception regarding the services offered by the Company may be disadvantageous in relation to those offered by competing companies.

▶ The Company may not adequately anticipate and adapt to the technological changes and trends in the sector.

▶ The Company depends on a network of suppliers.

▶ Any Network failures may lead to a loss of quality or an interruption of the service.

▶ The telecommunications industry may be affected by the potential effects that the electromagnetic fields emitted by mobile devices and base stations may have on people's health.

The Risk Management Model is adapted to the evolution of the typologies of the main risks

▶ Potential changes of a regulatory, business, economic or political nature may lead to the possible reorganisation of accounts for certain assets.

▶ The Telefónica Group's networks transport and store large volumes of confidential, personal and business data and its Internet access services and hosting services may give rise to claims for illegal or illicit use of the Internet.

▶ Telefónica and the Group companies are parties in litigation, claims of a fiscal nature and other legal proceedings.

In addition, the environmental aspects of telecommunications operations have their greatest risk focus on high geographical dispersion and energy consumption, which are controlled through environmental management based on uniform processes and a global energy efficiency programme.

RISK RESPONSE AND MONITORING

The Corporate Risk Management Model, which takes into account the provisions of the main international references and best practices, includes both the identification and assessment of risks, as well as the response to them and subsequent monitoring.

In accordance with the diverse risk typologies, the risk response mechanisms include global initiatives, homogeneously promoted and coordinated within the Group's main operations and/or actions specifically aimed at addressing concrete risks in any one of its companies.

Finally, we should point out that the Model is adapted to the evolution of the typologies of the main risks and we have observed an increasing relevance of those risks related to intangibles and global significance, such as sustainability, public image and the social impact of organisations.

GENERAL OUTLINE OF THE RISK MANAGEMENT MODEL
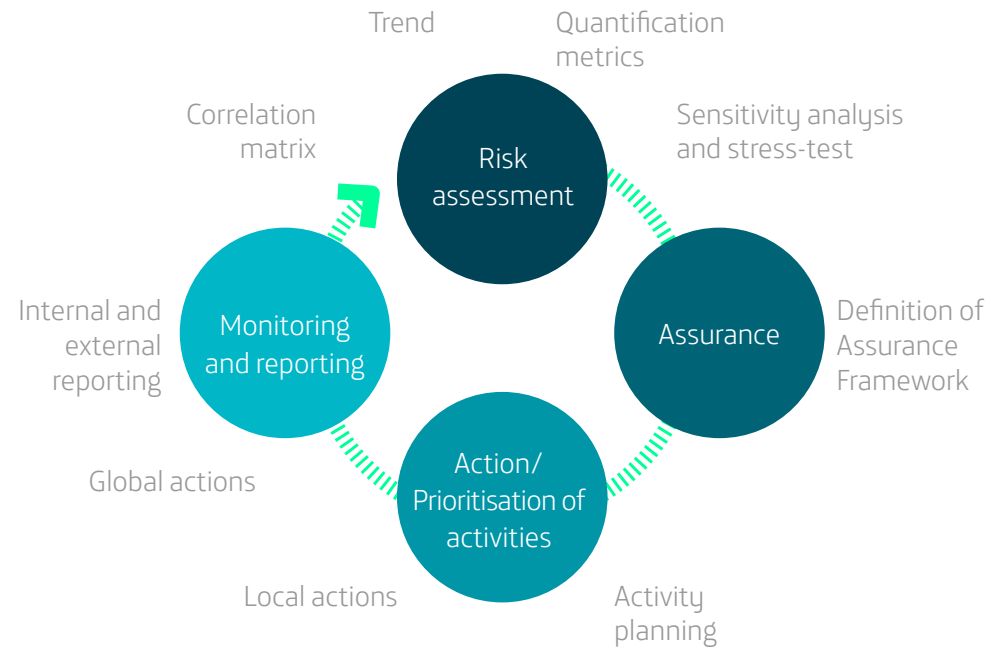
EVOLUTION OF THE MAIN RISKS

# Sustainability governance and management_

Our sustainability strategy is based on the responsible management of our business, and not only focuses on managing certain risks, but also on seizing opportunities, efficiency and sustainable growth. This allows us to contribute to the social and economic development of society, making the communities in which we operate more prosperous, and providing better and more inclusive engines of progress. In this way we link our sustainability targets to the development and management of the business, incorporating them into processes and goals so that they become part of Telefónica's DNA and thereby generate a culture of business principle which embraces all our stakeholders.

Therefore, business principle development requires a culture of integrity, commitment and confidence as basic principles to guarantee the trust and security of our customers and their personal data, as well as those of the other stakeholders which interact with the Company.

To achieve the above, we rely on a model of action structured on three levels of commitment, covering our entire value chain.
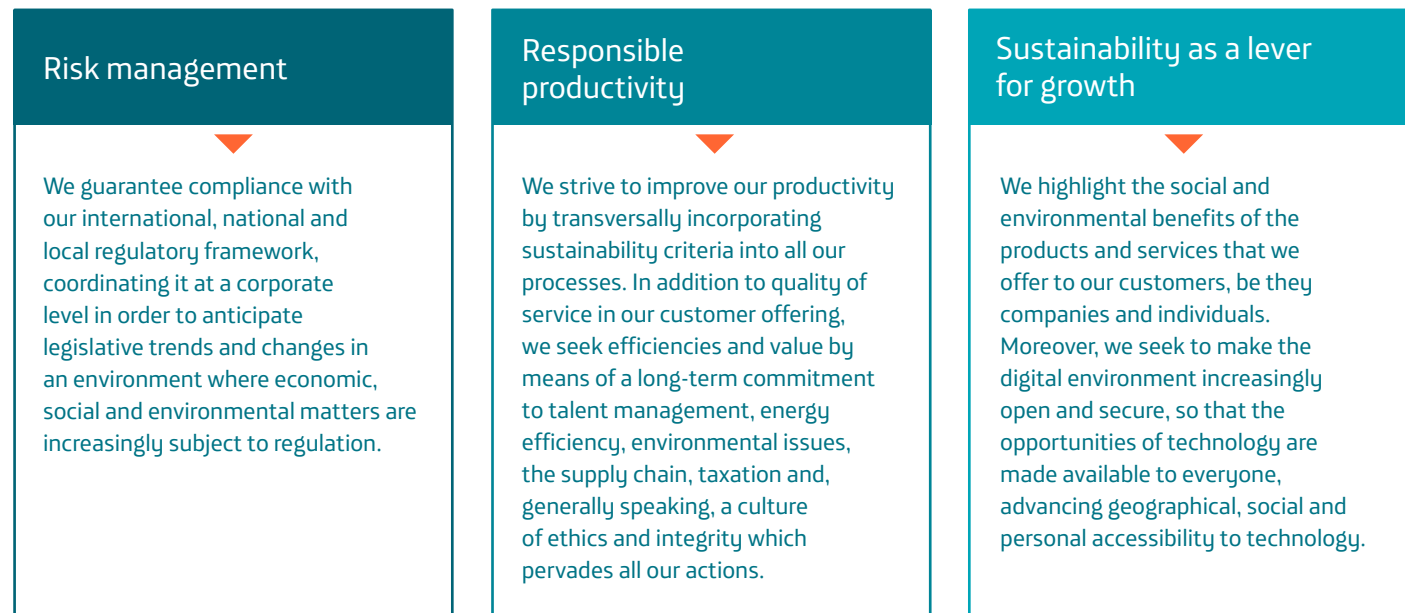
FURTHER INFORMATION
Refer to the "Strategy" section of our corporate website.

A BUSINESS PRINCIPLE for gaining the customer's TRUST	Talent and diversity	Sustainable management of the supply chain	Customer promise and digital trust	Environmental policy	Sustainable innovation

ACTION MODEL

Risk management

We guarantee compliance with our international, national and local regulatory framework, coordinating it at a corporate level in order to anticipate legislative trends and changes in an environment where economic, social and environmental matters are increasingly subject to regulation.

Responsible productivity

We strive to improve our productivity by transversally incorporating sustainability criteria into all our processes. In addition to quality of service in our customer offering, we seek efficiencies and value by means of a long-term commitment to talent management, energy efficiency, environmental issues, the supply chain, taxation and, generally speaking, a culture of ethics and integrity which pervades all our actions.

Sustainability as a lever for growth

We highlight the social and environmental benefits of the products and services that we offer to our customers, be they companies and individuals. Moreover, we seek to make the digital environment increasingly open and secure, so that the opportunities of technology are made available to everyone, advancing geographical, social and personal accessibility to technology.

The Company strategy points us to our Global Business Principle Plan, which is being implemented in the different local markets to achieve specific objectives. It covers the following priorities:

Customer promise

Digital trust

Supply chain

Diversity and talent management

Environmental management

Sustainable innovation

We have specific organisational units whose goal it is to ensure integrity and transparency in Telefónica's risk management processes

Telefónica's strategy and enforcement of sustainability has received recognition from the most prestigious global sustainability indexes, such as the Dow Jones Sustainability Index (DJSI), the Carbon Disclosure Project (CDP), Sustainalytics, Ethibel, MSCI and FTSE4Good.

We have also achieved the GOLD level of recognition in the sustainability rating performed by EcoVadis, a collaborative platform which allows companies to monitor their own performance in this area, as well as that of their suppliers.

HOW WE GOVERN SUSTAINABILITY
The highest body responsible for sustainability at Telefónica is the Board of Directors. On the one hand, the Institutional Affairs Committee is responsible for approving and monitoring the Business Principle Plan while, on the other, risks are reported to the Audit and Control Committee. Both committees meet regularly, on a monthly basis.

At an executive level, the General Board of Sustainability and Corporate Ethics is responsible for proposing and coordinating the sustainability strategy, reporting directly to the Global Head of Public and Regulatory Affairs.

In addition, the Business Principle Office is the transversal body responsible for overseeing implementation of the plan in all the Company's activities. This Office is replicated at a country level, in virtually all of Telefónica's operations, and is made up of the areas of Human Resources, Internal Audit, Secretary General, Chief Commercial Development Officer, Purchasing, Operations, Communication, Marketing and the General Board of Sustainability and Corporate Ethics.

Furthermore, we have specific organisational units whose goal it is to ensure integrity and transparency in our risk management:

▸ Internal audit units in all the countries in which the Group has significant interests.

▸ An inspection unit specialising in fraud prevention work and the investigation of complaints.

▸ A payment intervention unit in the most important companies.

▸ Global management and local units for sustainability.

▸ A corporate risk management unit which centralises and reports the risk information received from local risk management areas, implemented in the main Group operators.

▸ Business Principle Office in all countries, made up of the managers of the areas of Secretary General, Auditing, Human Resources, Purchasing, Operations, Marketing and Sustainability.

▸ On 24 February 2016, the Board of Directors of Telefónica, S.A. approved the creation of the position of Chief Compliance Officer at corporate level, to reinforce and strengthen the Telefónica Group's culture of compliance.

FURTHER INFORMATION
Refer to the "Governance" section of our corporate website.

Ethics and compliance_

OUR CHALLENGE

Ethics and responsible business development are fundamental pillars of our corporate culture and our commitment to serving customers and society.

These pillars are embodied by:

▶ **Our Business Principles.** These govern all our actions as employees, as well as our relationships with shareholders, customers, suppliers and society.

▶ **Our commitment to Human Rights**. As part of our due diligence and compliance process, in 2015 we continued to transversally integrate the results of our 2012 global impact assessment into all our operational processes. (Refer to the 'Compliance with Human Rights' chapter to see the progress made in each of the identified lines of action).

OUR BUSINESS PRINCIPLES

Our Business Principles constitute the fundamental standards which apply to Telefónica's commitments in matters of labour, good governance, sustainability, ethics and regulatory compliance. Within the text we also include requirements for our partners and suppliers to act in accordance with similar principles.

Since 2006, the year in which it was approved, the code has been revised in order to adapt to the new realities facing the Company. In 2015 the principle of Integrity was reinforced, with the inclusion of a specific section in matters of corruption in order to strengthen our commitment to ethics and regulatory compliance. In the same regard, a new Anti-Corruption Policy has been approved, governing the acceptance or offering of gifts and invitations and prohibiting any form of bribery; as has a corporate standard on conflicts of interest, which establishes mechanisms whereby our employees may report all situations entailing a conflict of interest.

Telefónica is a registered lobbyist in the voluntary register of the European Union, reporting expenses related to lobbying activities of 2 million euros and 4,400 million euros received in grants.

The Business Principle Office oversees the disclosure of and compliance with our Business Principles. Over the past year, the Office has expanded its team through the addition of Marketing, Purchasing and Operations to the Office's existing areas (Human Resources, Legal, Internal Audit and Sustainability). We also have local offices set up for the Group's
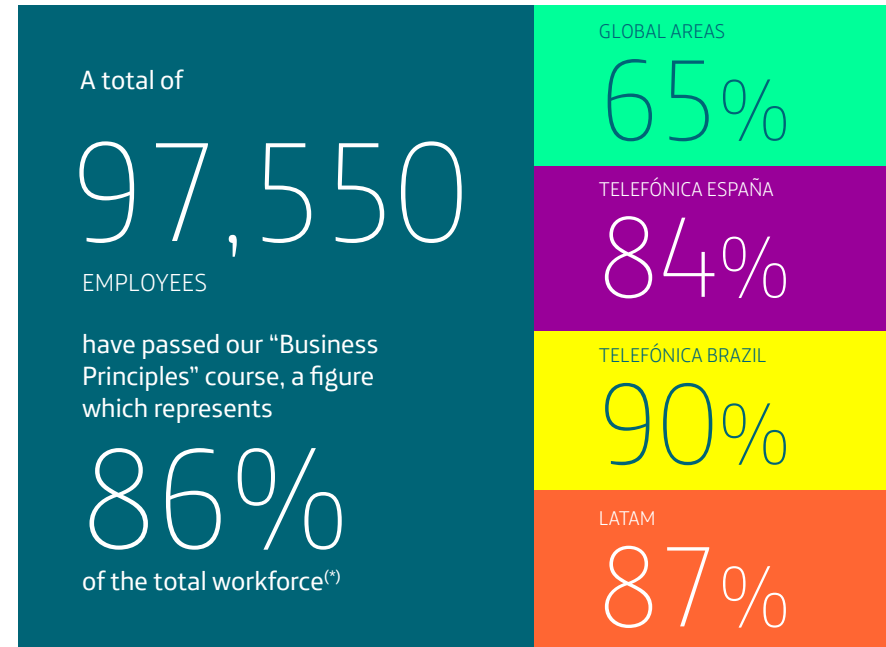
major operations, as well as the figure of Compliance Officer in Germany.

During 2015 we launched a second online training activity, mandatory for all Group employees, which had the purpose of refreshing our professionals' knowledge of the Business Principles. At the time of writing this

A total of

97,550

EMPLOYEES

have passed our "Business Principles" course, a figure which represents

86%

of the total workforce[*]

GLOBAL AREAS

65%

TELEFÓNICA ESPAÑA

84%

TELEFÓNICA BRAZIL

90%

LATAM

87%

FURTHER INFORMATION
Refer to the "Business Principles" on our corporate website.

Report, a total of 97,550 employees had completed it, a figure which represents 86% of the total workforce[*].

[*] The training data does not include the operations of Telefónica United Kingdom or Telefónica Germany.

BUSINESS PRINCIPLES CHANNEL

All our employees have the option of, anonymously or personally, reporting issues associated with compliance with the Business Principles and their associated policies. Along with other media, we operate a Business Principles channel where all correspondence is received and treated in accordance with the principles of respect, confidentiality and thoroughness.

When a reported situation contains sufficient information to allow its analysis, the corresponding investigation is carried out in accordance with our internal procedures.

During 2015, through the Channel of Business Principles and other media, we registered a total of 822 items of correspondence, including inquiries and complaints. 464 investigations were closed this year, 206 of which were found

During 2015, we registered a total of:

822
COMMUNICATIONS

464
CLOSED INVESTIGATIONS

206
INVESTIGATIONS FOUND TO BE JUSTIFIED

to be justified. The measures taken include 38 disciplinary dismissals. None of those investigations closed this year were related to cases of corruption or discrimination.

INTERNAL MONITORING

Telefónica on a number of specific committees and units that help guarantee the appropriate levels of control and transparency. During 2015, in the execution of its annual work plan, the Internal Audit area produced a total of 721 reports on Group activity:

▶ Fraud prevention, investigation of complaints and the review of individual actions.

▶ Total or partial analysis of the processes related to costs and investment.

▶ Reports aimed at verifying proper compliance with other legal obligations.

721 Reports

28%
7%
17%
24%
9%
7%
8%

FURTHER INFORMATION

Go to the section titled "Governance" on our corporate website.
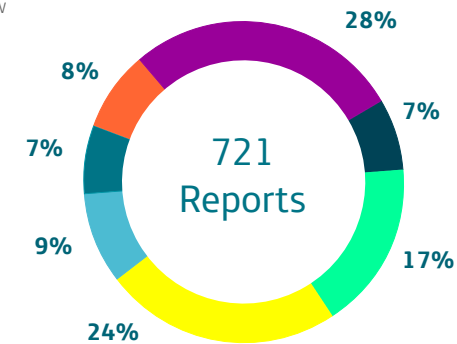
▶ Financial audits or information systems intended, primarily, for review of internal monitoring of the financial processes.

▶ Other works.

▶ Supervision of the main technological risks and compliance with legal provisions affecting the service networks and those affecting the information systems.

▶ Review of income.

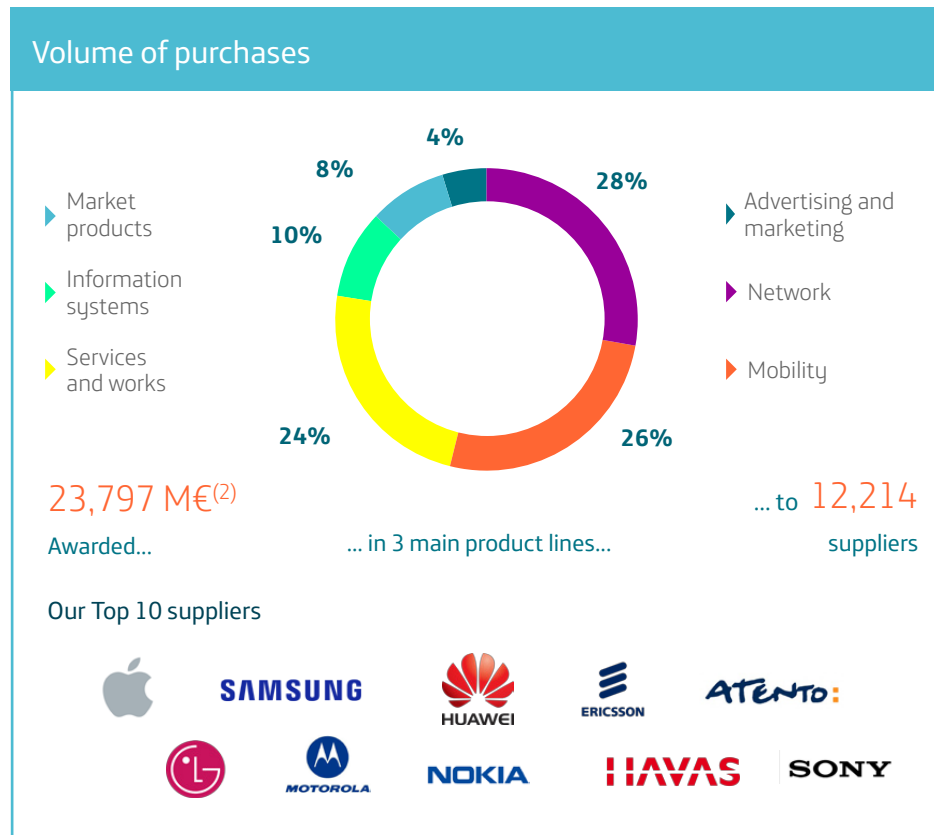| Milestones 2015	Compliance	Challenges 2016
▶ Completion of the project to review the code of ethics, in accordance with best business practices and in compliance with existing legislation.	Completed	Creation of a stakeholder communications channel.
▶ Development and adoption of standards that guarantee optimum levels of corruption and fraud control.	Completed	Internal sensitisation in matters of corruption and bribery.
▶ Business Principles awareness campaign for employees. Between 70% and 90% of the workforce will be trained in our Business Principles during the 2015/2016 period.	Completed	Creation of a compulsory training programme on the new learning tool.
▶ Definition, in Colombia, of the Mechanism for Human Rights Complaints and Claims, directed at communities.	Completed	Design and implementation of the complaints mechanism in Colombia, and definition of its conceptual and operational framework.

Management of the supply chain_

At Telefónica, all purchases are made in accordance with a common management model, which is characterised by the globalisation of purchases, without losing sight of the local needs of the different countries and business lines, ensuring coordinated and transparent management with our suppliers.

We are aware of the impact of our activity on society and, therefore, with the help of new technologies, we seek more efficient and innovative processes, which enable us to contribute positively to achieving a more sustainable environment.

OUR SUPPLY CHAIN IN FIGURES[1]

Volume of purchases

▸ Market products

▸ Information systems

▸ Services and works

▸ Advertising and marketing

▸ Network

▸ Mobility

28%
26%
24%
10%
8%
4%

23,797 M€[2]

Awarded...

... in 3 main product lines...

... to **12,214** suppliers

Our Top 10 suppliers

Apple · SAMSUNG · HUAWEI · ERICSSON · ATENTO: · LG · MOTOROLA · NOKIA · HAVAS · SONY

Impact on the community

We are aware of both the local and global impact of our activity on society.

85% of the **volume of purchases** was awarded to **local suppliers**

A consolidated global purchasing model through **Telefónica Global Services...**

... which managed **21,334 purchasing processes, amounting to 16,487 M€**

Our principles

We seek to ensure that our activity is carried out with transparency and integrity.

We promote the use of e-commerce tools, which help us to ensure that our management of the supply chain is carried out with efficiency and transparency, guaranteeing equal opportunities.

29,423 M€[3] negotiated electronically

18,674 M€ in electronic formalisation operations (assignment letters, orders and contracts)

We received **873,891** electronically issued invoices

▸ We continue to make progress in the interconnection of the systems of Group companies with those of our suppliers, with over 47,062 orders.

▸ More than 11,100 suppliers were trained in the management of negotiations, orders and electronic invoices (compared with more than 8,800 suppliers in 2014).

(1) Does not include the figures associated with the purchasing processes performed by Telefónica United Kingdom.
(2) Volume awarded in the 2015 budget year.
(3) Volume traded in 2015, regardless of the budget year of the purchase.

OUR PURCHASING PROCESS

Promoting a culture of sustainability within our value chain is one of the key objectives of Telefónica's Business Principle Plan. Therefore, ever since we assumed our public commitment in 2010, we have striven to incorporate social responsibility as another aspect to be borne in mind in each of the phases of the purchasing process and in the relationship with our suppliers. As such all the contracts that Telefónica holds with suppliers include specific clauses covering human rights.

As a result we are able to identify and manage potential risks, while fostering a culture which promotes social and environmental commitment throughout the supply chain.

OUR SUSTAINABLE MANAGEMENT MODEL

At Telefónica we base our model for the sustainable management of the supply chain on the following four Value Drivers.

Efficient production

▸**Marco Polo Model**
We are reinforcing Telefónica's position as a Digital Telco by providing our own brand of home equipment. This allows us to be more competitive in terms of both added value and distinctiveness, thanks to new features which

Our Value Drivers

Efficient production

▸**To reduce costs** of materials, energy and transport.
▸The development of **strategic relationships with suppliers** to optimise the process, products and services.

Culture of sustainability

▸**To train** and involve suppliers and employees.
▸To build **strong relationships** with stakeholders.
▸**Positioning** in the **sustainability indices**.

Risk management

▸**To minimise risks** (ethical, social, environmental).
▸**To protect the reputation** and value of the brand.
▸To facilitate **access to financing and insurance**.

Engagement

▸**To promote a close relationship** and share good practices.
▸To establish **communication channels** and develop on-site forums.

respond directly to our customers' connectivity needs.

We manage and optimise the entire end-to-end process, from the definition of the product and its technical specifications to the final delivery of the equipment, as well as other critical actions such as the approval of the equipment and the centralised management of the purchases.

Since the Marco Polo model was introduced in 2013 we have managed to establish a portfolio of products common to all our operations, allowing us to downsize to 10 teams from 28 in 2015 and achieve efficiencies above 45 million euros.

▸**Technological partners**
Within the framework of the Company's Energy Efficiency Project, we work with technological partners who provide us with the best technology and help us to identify opportunities to reduce energy consumption and emissions.

▸**Strategic alliances**
We have launched a strategic collaboration programme with China Unicom for the joint purchase of terminals. The programme's aim is to select smartphones with common specifications, thus allowing both companies to provide better data services to a broad base of customers in Latin America, China and Europe.

Culture of sustainability

In accordance with our Business Principles, we require all our suppliers to carry out their activity applying similar ethical standards to ensure compliance with fundamental human and labour rights and respect for the environment.

The principles we promote among our suppliers include those related to labour rights, such as eliminating child, forced and compulsory labour, promoting the effective recognition of collective bargaining and support for freedom of association.

To be a Telefónica Group supplier, in addition to technical requirements and quality standards, the company must agree to comply with certain minimum business principle criteria, set out in our:

▸ Policy for Responsibility in the Supply Chain.

▸ Commitment to Human Rights.

▸ General conditions for the supply of goods and services.

Throughout the different phases of the purchasing process we encourage our suppliers to fulfil these minimum criteria while promoting similar standards in their own value chains.

In the event that a supplier does not achieve the required level or is not able to provide the requested information, we shall implement the processes necessary for achieving its commitment with a view to implementing improvement plans which ensure compliance with our standards.

In extreme cases, where this is not feasible, upon the basis of the agreement initially signed by both parties, the relationship with the supplier shall be suspended until it proves that it has corrected the situation.

▸ **Strong relationships with our partner companies**
We seek forms of cooperation with our partner companies and contractors which will help us to establish sustainable management, with the aim of turning them into strategic partners and increasing customer satisfaction.

In Latin America, our Partner Programme has become one of the leading initiatives in this field. Since it was launched in 2008, we have worked closely with our suppliers to promote a culture of sustainability which guarantees service excellence for our customers.

We want to ensure the formation of these strategic partnerships in order to guarantee compliance with organisational objectives, technical security and equity, while at the same time developing mechanisms for the early detection and prevention of risks and sensitizing contractors with regard to compliance with Telefónica's standards.

We employ a management model based on global tools - such as our policy of minimums and the third-party committee - which allow us to develop different lines of action at a local level, taking into account the situation in each of the countries. The different initiatives undertaken during 2015 include:

▸ Implementation of a contractor control system (Argentina, Chile, Mexico and Peru).

▸ We began the implementation stage of the OSHAS 18001, which also involves suppliers in different countries (Argentina and Colombia).

▸ Preparation and organisation of documentation regarding the Occupational Health and Safety Management System, based on the requirements of the International Labour Organization (Chile).

▸ Implementation of the partner management model in the distribution channel (Colombia).

▸ Development of the action plan for attending to special audits by the Ministry of Labour (Venezuela).

Throughout the year we reinforced training initiatives with our internal managers and our suppliers, addressing the specific needs of each country. Such training is conducted in person or via the ICampus online platform.

More than

4,500

courses conducted with our partners in Latin America

We evaluated 190 critical suppliers via the EcoVadis platform and another 20 are currently undergoing the process, thus achieving the target set for 2015

During 2015, at Telefónica España we promoted dialogue between the union representatives and our partner companies to resolve the labour disputes which led to a strike. Thus, in May, an agreement was reached between the two main unions - UGT and CCOO - and the ten affected companies in order to improve the working conditions of the employees of contracted companies.

Risk management

Preventing and reducing the potential negative impacts of our activity is another of the objectives of our Business Principle Plan, as well as those negative impacts which may arise in relation to our suppliers; therefore, this is one of our main lines of action in the management of the supply chain.

In 2015 we focused once again on applying our control and monitoring mechanisms to track the activity of our risk suppliers, classified as such either due to their activity or to their volume of allocations.

▶ **360° assessment of risk suppliers**
We analyse and assess the risk level of our suppliers, depending on the product and service they provide us. To do this, we rely on the self-assessment platform of EcoVadis, an external independent body. As a result of its online tool we obtain a 360° assessment of the performance of our leading risk suppliers, based on 21 sustainability criteria.

We have evaluated 190 critical suppliers by means of EcoVadis and 20 other suppliers are currently undergoing the process, thereby achieving the target set for 2015. The percentage of suppliers which have shown some kind of weakness - medium risk - in their sustainability management has remained at around 30%, with the main risks once again being those affecting the sustainable management of the supply chain itself.

Of the critical suppliers, 40 have active corrective action plans, representing a total of 455 corrective actions.

▶ Relevant indicators:

  ▶ 45% (+4%) have the OHSAS 18001 or equivalent certification, thus demonstrating the organisation's ability to meet the requirements of health and safety legislation.

  ▶ 73% of suppliers have complaints procedures.

  ▶ 67% (+1%) of the assessed suppliers have the ISO 14001 environmental management certification.

  ▶ 78% (+5%) report use of energy or GHG emissions.

▶ **Annual Audit Plan**
Our plan is defined in accordance with the risks of each region or country and the type of supplier, and thus focuses it assessment on the performance of our suppliers in the most critical aspects.

Once again, in Latin America we have focused our efforts on managing the risk associated with labour-intensive partner companies and third parties by means of the Aliados Programme.

We have performed more than 15,550 administrative audits and more than 1,470 on-site audits on risk suppliers, addressing locally critical issues in both cases. Given the results obtained, improvement plans for more than 600 suppliers have been proposed.

In addition, we have conducted 100 corporate audits in 8 different countries (42% more than in 2014), using homogeneous sustainability criteria at a regional level, on the basis of a four pillar model: Business Principles, Human Resources (with particular emphasis on compliance with labour obligations), Health and Safety and the Environment.

In general, the results of these audits display minor variations on 2014, the suppliers' level of compliance remaining within the top area of performance. The 82% compliance registered in the Human Resources discipline is a clear example of the importance of labour obligations for our partners and the work we perform with them in this regard.

The areas for improvement we have detected include, above all, helping our partners to transfer the sustainability issues contained in our Policy for Sustainability in the Supply Chain to their own suppliers.

The distribution of risks has remained stable. Some of the most common risks have been detected in:

▸ The Induction Process, Training, Climate and Welfare, as well as Personnel Relationships and Management.

▸ With regard to Health and Safety aspects, these have focused on the sections of Industrial Hygiene and Safety (occupational health, preventive medicine at work, the Joint Health and Safety Committee and the emergency brigade).

▸ And concerning environmental processes, the structure of the environmental programme, waste management and the consumption of materials and resources.

We are working together with the suppliers to carry out improvement plans, defined for each of the suppliers which have displayed some kind of non-compliance.
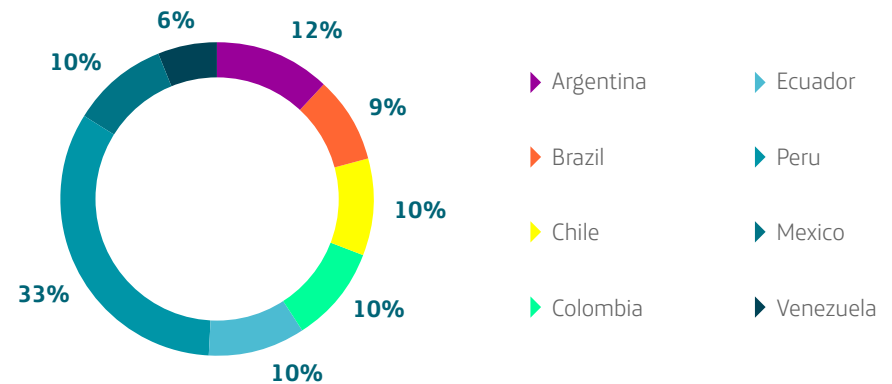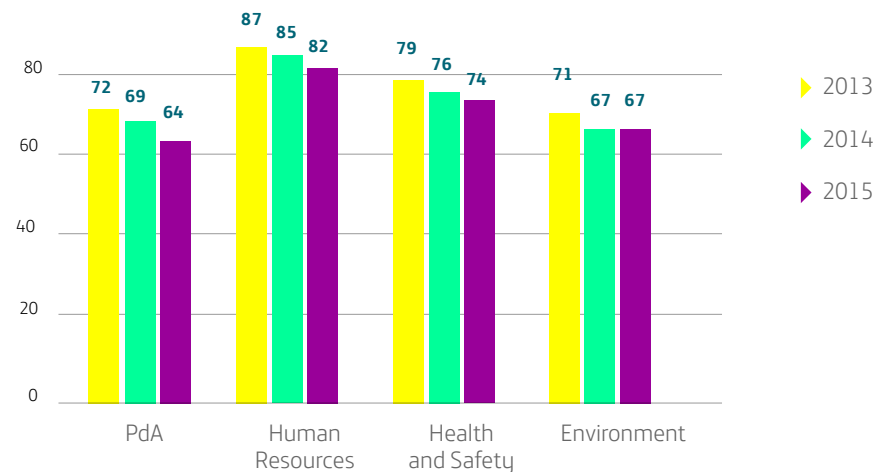
Engagement

We promote constant communication with our suppliers in order to maintain a close relationship with them and to promote a culture of sustainability in our supply chain.

▸ They have access to various communication channels, such as our quarterly partner bulletin (Colombia, Ecuador and Mexico) the Partner Portal and the Supplier Portal. In the latter they can find all our policies as well as a confidential channel for questions and complaints relating to the fulfilment of our minimum business principle criteria.

▸ During 2015 we held direct meetings with some of our main global suppliers, at which we shared our strategies on sustainability issues and exchanged good practices.

▸ We used the online channels to organise specific webinars on aspects which we considered of interest to our suppliers. For example, in Ecuador we held the "Movistar Shield" webinar, at which we conveyed our interest in contributing to a secure environment for the use of ICT for customers, suppliers and distributors.

▸ At a local level, we also organise on-site events with suppliers, including the following:

▸ Meetings of Telefónica's Partner Companies in Latin America, in which internal managers, suppliers, distributors, etc., participate. In 2015 these were held in Chile, Ecuador and Mexico.

▸ Working breakfasts, such as the three organised in Guatemala last year to

DISTRIBUTION OF AUDITS BY COUNTRY

6% · 12% · 9% · 10% · 10% · 10% · 33% · 10%

▸ Argentina
▸ Brazil
▸ Chile
▸ Colombia
▸ Ecuador
▸ Peru
▸ Mexico
▸ Venezuela

PERCENTAGE OF COMPLIANCE IN THE CORPORATE AUDITS IN LATIN AMERICA

	PdA	Human Resources	Health and Safety	Environment
2013	72	87	79	71
2014	69	85	76	67
2015	64	82	74	67

convey the importance of Sustainability in companies and to pass on to them how our Business Principles apply to suppliers.

▸ Thematic workshops, such as the one on Energy and Climate Change, at which Telefónica and its major suppliers analysed different plans to boost energy efficiency and reduce CO_2 emissions in the world of telecommunications.

RELEVANT ASPECTS FOR OUR BUSINESS
Once again we maintained our commitment to key aspects of the supply chain with high social impact, such as child labour and minerals in conflict.

Eradication of child labour
Preventing and eradicating child labour is an international goal which is present on the development agendas established by the different countries. Therefore, once again we continued to collaborate in some of the main initiatives launched in this area, such as the Colombia Network Against Child Labour, made up of 35 companies and headed by the Ministry of Labour.

As a strategic partner of this Network, at Telefónica Colombia we publicised our commitment to manage and be held accountable for this risk. We also participate in the Communications Committee and form part of the Technical Committee together with the Ministry of Labour, the Local Network of the Global Compact and the Colombian Family Welfare Institute, among others.

Since the launch of the Colombia Network Against Child Labour, the "Here I am Taking Action" tool was made available to the participating companies so that they could self-diagnose the risk of child labour in order to promote respect for the rights of children and teenagers in the supply chain and the area of influence. In 2015 we conducted five workshops in three different cities: Neiva, Cali and Bogotá. In the latter the exercise was carried out in conjunction with the Colombian Association of Flower Exporters of Colombia, coal suppliers of the Bogotá Energy Group and members of the Colombia Network Against Child Labour.

The work performed since its launch has led to 136 companies being registered and has affected more than 226,000 employees.

Minerals in conflict
Within the Telefónica Group, despite not having any direct commercial relationships with smelters or refiners, we actively strive to include sustainability criteria throughout the value chain.

In this regard, we have adopted a company policy based on the guidelines contained in the report titled "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas" published by the OECD. It is a policy which incorporates the Guide's five stages and which we pass on to our suppliers.

1. Traceability of 3TG minerals
We encourage our suppliers to carry out effective due diligence processes to guarantee, whenever necessary and possible, the traceability of 3TG minerals from areas of conflict, as well as the mitigation of the associated risks, such as the violation of Human Rights.

In addition, any supplier which submits an offer must:

▸ Provide the express assurance that, to the best of its knowledge, after performing an appropriate and thorough analysis, the products offered do not contain any so-called "Minerals in Conflict".

▸ Have a clear policy on minerals in conflict which promotes the adoption and use of the OECD guidelines for multinational companies and the guiding principles of the United Nations on business and human rights for internal use and for the entire supply chain.

Among the suppliers assessed:	69% have a policy on minerals in conflict	82% implement actions to identify the presence of or mitigate risks	43% publish a report on due diligence	

The supplier must have a management system to comply with this policy.

2. Assessment of suppliers

We analyse and assess the performance of our suppliers by means of the EcoVadis platform. Thus, within the module that assesses the management of their own supply chains, we analyse the risk suppliers in regard to certain aspects of this field:

▶ Whether they have a policy on minerals in conflict.

▶ Whether they publicly support any of the international or sectoral initiatives in this regard.

▶ The different actions implemented to identify the presence or to mitigate the risks of the minerals in conflict within their own supply chains (identification mechanisms, inclusion of clauses, external certifications, etc.).

▶ Which specific measures they implement to engage their own supply chain in this respect.

▶ Whether they publish a due diligence report in this regard.

In 2015 we continued with the assessment of our suppliers of devices, one of the most important lines due to their volume of allocations and their high risk in view of the significant levels of use of these types of minerals in the manufacture of their components.

3. Engagement initiatives

We also support and participate in major initiatives, both international and sectoral, aimed at reducing these kinds of risks, such as the Public-Private Alliance for Responsible Minerals Trade (PPA).

4. Complaints

We continue to work internally to establish a unified complaint mechanism for the whole Group.

5. Information

We report on the due diligence of the supply chain.

In addition, at Telefónica, as a company listed on the New York Stock Exchange, we duly comply with Section 1.502 of the Dodd-Frank Wall Street Reform and the Consumer Protection Act.

FURTHER INFORMATION

Refer to the "Supply Chain" section of our corporate website.

CHALLENGES 2016

▶ A review of the minimum business principle criteria we require of our suppliers, in keeping with the new aspects relevant to the field of sustainability for the value chain.

▶ Put special focus on suppliers related to the provision of services, concentrating our attention on the most significant risks.

▶ Expand the scope of the EcoVadis assessment process, including Telefónica's 250 main risk suppliers.

▶ Incorporation of Telefónica into the JAC (Joint Audit Cooperation) sectoral initiative, in order to perform joint audits on critical suppliers.

▶ Encourage the participation of our suppliers in the different dialogue initiatives which the Company provides for stakeholders, in order to find new areas for cooperation.

MILESTONES 2015

Given the challenges set for 2015 and the different lines of action on which we worked throughout the year, our milestones include:

▶ A review of the framework contracts of some of our major global purchases, such as terminals, ensuring the inclusion of the minimum sustainability criteria to be met by potential suppliers, given the type of product or service we acquire.

▶ 190 critical suppliers assessed by means of EcoVadis with 20 currently undergoing the process, thus achieving the target set for 2015.

▶ 1,577 on-site audits (both local and corporate) performed on risk suppliers, whose results have led to the proposal of 608 supplier improvement plans.