

Supervisory Board Report for the 2016 financial year_



Eva Castillo Sanz,
Aufsichtsratsvorsitzende der
Telefónica Deutschland Holding AG

Dear Shareholders,

In the interests of good corporate governance, the Supervisory Board collaborated well with the Management Board on the basis of trustful cooperation, advised it and fulfilled its controlling responsibilities in the reporting period with regard to all significant topics. The Supervisory Board of Telefónica Deutschland Holding AG consistently and responsibly performed its duties as set out by law, the Articles of Association and the by-laws.

Composition of the Supervisory Board

At the beginning of the 2016 financial year, the Supervisory Board consisted of 16 members, being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Angel Vilá Boix, Laura Abasolo García de Baquedano, Patricia Cobián González, Sally Anne Ashford, Antonio Manuel Ledesma Santiago, Michael Hoffmann and Enrique Medina Malo as well as the employee representatives Imke Blumenthal (Vice Chairperson of the Supervisory Board), Marcus Thurand, Thomas Pfeil, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Christoph Heil and Claudia Weber.

With effect of the end of the Annual General Meeting on 19 May 2016 Antonio Manuel Ledesma Santiago resigned as member of the Supervisory Board. Following the proposition of the nomination committee the Annual General Meeting elected Peter Erskine as new member of the Supervisory Board for the shareholder representatives. His term of office began with the end of the Annual General Meeting on 19 May 2016.

With effect from 30 June 2016 Imke Blumenthal left the Supervisory Board. Christoph Braun automatically succeeded her as a member of the Supervisory Board with effect from 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

In the Supervisory Board of Telefónica Deutschland Holding AG, Michael Hoffmann performs the function of the independent financial expert within the meaning of number 5.3.2

of the German Corporate Governance Code and has the knowledge as requested by section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

In 2016 the Management Board comprised three members: next to Thorsten Dirks as CEO, Markus Haas was responsible for the operative business as Chief Operating Officer (COO) and Rachel Empey for finance and strategy as CFO. Markus Haas also performs the function as Labour Director.

The supervisory board had approved on 21 November 2016 as per Thorsten Dirks' request an early termination of his contract. Thorsten Dirks left –as mutually agreed – by the end of 31 December 2016 the management board and as CEO.

The supervisory board appointed with resolution on 11 December 2016, Markus Haas as CEO of Telefónica Deutschland Holding AG effective as of 1 January 2017.

Rachel Empey, in addition to her previous responsibility for Finance and Corporate Strategy, is since 1 January 2017 also responsible for the areas of Transformation & Integration, Business Intelligence, Innovation and Telefónica Next.

Cooperation between the Management Board and Supervisory Board

The Management Board provides the Supervisory Board with a monthly written report, which covers in particular relevant financial key performance indicators (KPIs).

The Chairperson of the Supervisory Board and the Management Board are also in constant contact outside Supervisory Board meetings. Here they discuss in particular the current position and future development of the company as well as the progress of current material projects, in the reporting period among others especially transformation and integration measures and digital development into an Onlife Telco. The Chairperson of the Supervisory Board informs the other members of the Supervisory Board of important issues discussed in that context.

In the reporting period, the Management Board involved the Supervisory Board in due time in all actions requiring its approval. For this purpose, it submitted reports and documents to the Supervisory Board and provided additional information when required. When necessary, the Supervisory Board was also able to refer to the expertise of external consultants.

Meetings of the Supervisory Board

In 2016, four ordinary meetings of the Supervisory Board took place, namely on 19 February (meeting on the financial statements for the 2015 financial year; "Bilanzsitzung"), 7 April, 18 July and 20 October 2016. Meetings of the Audit Committee were also held on these days. In addition, there were five extraordinary meetings of the Supervisory Board (sometimes by telephone, video conference, sometimes in person) and further resolutions of the Supervisory Board outside of meetings.

So far there has been one Supervisory Board meeting in 2017: on 16 February 2017 (meeting on the financial statements for the 2016 financial year; "Bilanzsitzung").

Fundamental issues dealt with by the Supervisory Board

The first ordinary meeting of the Supervisory Board in the 2016 financial year on 19 February 2015 was also the meeting regarding the financial statements for the 2015 financial year ("Bilanzsitzung"). In addition to the items associated therewith, such as the approval of the financial statements (Group and of the corporation) and the combined management report for the 2015 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), in particular the final agenda and resolution motions for the Annual General Meeting on 19 May 2016 were agreed, Corporate Governance topics and preparatory measures for the sale of passive tower infrastructure to Telxius Telecom, S.A. (Telxius S.A.), which ultimately took place in April, were discussed.

In addition to the financial data and the outlook, the ordinary meeting on 7 April 2016 discussed operational issues and the results of the employee survey as well as the change of auditor for the financial year 2017. The Supervisory Board also approved the sale of passive tower infrastructure to Telxius S.A.

Among other things, the ordinary meeting on 18 July 2016 addressed the half-yearly financial data, the election of Christoph Braun as the new Deputy Chairperson of the Supervisory Board, corporate culture, Advanced Data Analytics and Internet of Things, compliance and Supervisory Board efficiency.

The topics discussed at the ordinary meeting on 20 October 2016 included financial issues (especially the Q3 results and the business plan), the results of the Supervisory Board efficiency survey and diversity. It was also agreed that the

Annual General Meeting for the 2016 financial year would be held on 9 May 2017.

The Supervisory Board held extraordinary meetings in the reporting period (sometimes by telephone, sometimes via video or in person) during which, in particular, it approved the budget for the financial year 2017 and discussed matters relating to the Management Board (especially on 21 November 2016 the early leaving of Thorsten Dirks and on 11 December 2016 the appointment of Markus Haas as new CEO with effect as of 1 January 2017).

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, operational issues including the synergy reports and the market positioning were dealt with.

In June 2016, the Supervisory Board also held a strategy workshop together with the Management Board.

All Supervisory Board members in office for the entire 2016 financial year participated in more than half of the meetings in the reporting period.

Outside of the meetings the Supervisory Board passed resolutions to the extent required, especially by e-mail. For instance, inter alia the resolution on the Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG) in October 2016 were passed this way – following appropriate preparation at presence meetings.

Committees of the Supervisory Board

As determined in its by-laws, the Supervisory Board has a Nomination Committee, a Mediation Committee and an Audit Committee. Since 7 March 2016, there exists furthermore a Remuneration Committee.

The Audit Committee is responsible in particular for advice on and the passing of resolutions in accounting matters. It deals with issues relating to accounting, internal control systems and auditing, risk management, compliance and the financial, asset and earnings situation. It also examines the required independence of the external auditor and is responsible for coordination with the external auditor.

The Committee consists of four members:

- Michael Hoffmann (Chairperson)
- Laura Abasolo García de Baquedano
- Thomas Pfeil and
- Christoph Heil.

In 2016, the Audit Committee met seven times. In addition to the regular topics financial results, auditing, risk management and compliance, it dealt in particular with the change of auditor for the financial year 2017.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:

- Eva Castillo Sanz (Chairperson)
- Christoph Braun (from 1 July 2016;
Imke Blumenthal until 30 June 2016)
- Angel Vilá Boix and
- Marcus Thurand.

The Remuneration Committee for the Management Board was formed by the full Supervisory Board by e-mail resolution on 4/7 March 2016. The Remuneration Committee is responsible for preparing topics and details relating to Management Board remuneration. In particular, its preparatory work supports the decision making process of the full Supervisory Board.

The Remuneration Committee has the following members:

- Sally Anne Ashford (Chairperson)
- Eva Castillo Sanz
- Dr. Jan-Erik Walter and
- Claudia Weber.

Furthermore, there is a Nomination Committee. The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González is the Chairperson of the Nomination Committee. The other members were Eva Castillo Sanz and Enrique Medina Malo.

The Nomination Committee prepared the election proposal for the Annual General Meeting on 19 May 2016, at which Peter Erskine was elected as successor of Antonio Manuel Ledesma Santiago.

Corporate Governance

Good corporate governance is essential for corporate success and is therefore in the interest of the company's shareholders. Further details on the corporate governance of Telefónica Deutschland Holding AG can be found in the Management Declaration pursuant to section 315 para. 5 in connection with 289a German Commercial Code in the Annual Report and on the company's website at WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION and in the Corporate Governance Report in the Annual Report and on the company's website at WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT

On 13/14 and 17 October 2016 the Management Board and the Supervisory Board approved a new Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG). It was updated on 11/12 December 2016. The Declaration of Compliance and its update were published respectively. You can find them in the Annual Report or at the company's website at WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE. Earlier versions of the Declaration of Compliance can be also found at this website.

Six of the 16 members of the Supervisory Board hold positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies. Both the Supervisory Board members and the Management Board members disclose potential conflicts of interest promptly to the Supervisory Board.

In the reporting period, no conflicts of interest within the meaning of the German Corporate Governance Code arose.

The Supervisory Board fulfils the gender diversity quota of at least 30 % (at the start of the financial year 2016: 37.5 %; after Imke Blumenthal stepped down with effect from 30 June 2016: 31.25 % female members).

In the financial year 2016, one-third of the members of the Management Board were female. Since 1 January 2017, the quota is 50 % (one member of the two member Management Board is female), so the established gender diversity quota of at least 20 % for the members of the Management Board is still exceeded.

Review of the Financial Statements 2016

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, branch Munich, audited the annual financial statements and the consolidated financial statements as well as the combined management report as of 31 December 2016 of Telefónica Deutschland Holding AG and the Telefónica Deutschland Group and each provided with an unqualified audit opinion. The annual financial statements and the combined management report of Telefónica Deutschland Holding AG and the Telefónica Deutschland Group were prepared in accordance with German commercial law. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as they are applied in the European Union (EU) and the additional requirements which have to be applied in accordance with section 315a para. 1 German Commercial Code (HGB). The auditor carried out the audit in accordance with section 317 HGB considering German principles of proper auditing set by the Institute of Public Auditors in Germany (IDW) as well as for the consolidated financial statements.

The financial statement documentation of the corporation and the group and the Management Board's proposal for the distribution of profit and the respective auditor's reports were submitted to the Supervisory Board in due time prior to the meeting on 16 February 2017 ("Bilanzsitzung"). The Audit Committee and the full Supervisory Board thoroughly examined the reports and discussed them in detail together with the auditor on 16 February 2017.

The Supervisory Board acknowledged and approved the auditor's findings in the audit reports and had no objections. At its meeting on 16 February 2017, the Supervisory Board approved the annual financial statements of Telefónica Deutschland Holding AG and the consolidated financial statements together with the combined management report for the 2016 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Relations to affiliated companies

The report on relations to affiliated companies (dependency report) as prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act was also audited by the auditor. With respect thereto, the auditor issued the following unqualified opinion (uneingeschränkter Bestätigungsvermerk):

"Based on our audit and assessment, which were carried out in accordance with professional standards, we confirm that

1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,
3. there are no circumstances that would require a materially different assessment of the measures listed in the report than that of the Management Board."

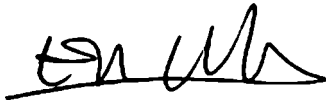
The dependency report as prepared by the management board and audited by the auditor as well as the audit report on the dependency report were submitted to the Supervisory Board in due time. Having examined the dependency report and the corresponding audit report in accordance with section 314 of the German Stock Corporation Act, the Supervisory Board had no objections against the dependency report and the Management Board's declaration on the relations to affiliated companies contained therein and agrees with the auditor's findings.

The Supervisory Board thanks the former Management Board member Thorsten Dirks for the excellent and collegial collaboration. The Supervisory Board thanks also Markus Haas and Rachel Empey and all employees for their dedica-

tion and excellent work in the past year. With their commitment, which in the reporting period was influenced in particular by integration and transformation, they have contributed considerably to the success of the company.

Munich, 16 February 2017

On behalf of the Supervisory Board

A handwritten signature in black ink, appearing to read 'Eva Castillo Sanz', written over a horizontal line.

Eva Castillo Sanz
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG