

Supervisory Board Report for the 2017 financial year



Eva Castillo Sanz,
Chairperson of the Supervisory Board of
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

During the 2017 financial year, the Supervisory Board consisted of 16 members, initially being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Ángel Vilá Boix, Laura Abasolo García de Baquedano, Patricia Cobián González, Sally Anne Ashford, Peter Erskine, Michael Hoffmann and Enrique Medina Malo as well as the employee representatives Christoph Braun (Vice Chairperson of the Supervisory Board), Marcus Thurand, Thomas Pfeil, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Christoph Heil and Claudia Weber.

All shareholder representatives were re-elected by the Annual General Meeting on 9 May 2017 for another period in office.

With effect of 4 October 2017, Ángel Vilá Boix resigned as member of the Supervisory Board. As requested pursuant to sect. 104 para 2 and 3 No. 2 German Stock Corporation Act (AktG) by Management Board, Julio Estéban Linares López was appointed as new member of the Supervisory Board by order of the Local Court of Munich of 16 October 2017.

In the Supervisory Board of Telefónica Deutschland Holding AG, the independent member Michael Hoffmann performs the function of financial expert with the knowledge as requested by section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

In the beginning of the financial year 2017, Management Board consisted of two members:

As CEO, Markus Haas was also responsible for the operative business of the whole Telefónica Deutschland Group and performed the function as Labour Director (Arbeitsdirektor). Rachel Empey was responsible for finance and strategy as CFO and additionally for the areas Transformation & Integration, Business Intelligence, Innovation and Telefónica Next.

In its meeting on 20 July 2017, Supervisory Board approved Rachel Empey's request of an early termination of her service agreement. As mutually agreed, Rachel Empey left the Management Board at the end of 31 July 2017. Supervisory Board appointed Markus Rolle as new CFO of Telefónica Deutschland Holding AG with resolution on 20 July 2017, effective as of 1 August 2017. Furthermore, Supervisory Board decided by resolution as of 20 July 2017 to extend the Management Board of Telefónica Deutschland Holding AG to eight members and thus appointed the following additional members of the Management Board of Telefónica Deutschland Holding AG, effective as of 1 August 2017:

- Wolfgang Metze as new Chief Consumer Officer
- Alfons Lösing as new Chief Partner and Business Officer
- Valentina Daiber as new Chief Officer Legal & Corporate Affairs
- Guido Eidmann as new Chief Information Officer
- Nicole Gerhardt as new Chief Human Resources Officer as well as Labour Director (Arbeitsdirektor), (Markus Haas resigned as Labour Director by the end of 31 July 2017)
- Cayetano Carbajo Martín as new Chief Technology Director.

Cooperation between the Management Board and Supervisory Board

The Management Board provides the Supervisory Board with a monthly 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 development into a digital telecommunications company. 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 material decisions. 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. Supervisory Board voted – where necessary – on resolution motions and reports of Management Board after thorough assessment and discussion.

Meetings of the Supervisory Board

In 2016, five regular meetings of the Supervisory Board took place, namely on 16 February 2017 (meeting on the financial statements for the 2016 financial year; "Bilanzsitzung"), 24 April, 20 July, 23 October and 18 December 2017.

In addition, there were further resolutions of the Supervisory Board outside of meetings.

In 2018, there were two meetings, on 2 February 2018 and on 19 February 2018 (meeting on the financial statements for the financial year 2017, "Bilanzsitzung").

Fundamental issues dealt with by the Supervisory Board

The first meeting of the Supervisory Board in the 2017 financial year took place on 16 February 2017 and was also the meeting regarding the financial statements for the 2016 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 2016 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 9 May 2017 were discussed. Moreover, the results of the employee survey as well as the operational and legal integration of E-Plus Mobilfunk GmbH into Telefónica Germany GmbH & Co. OHG were discussed.

The agenda of the Supervisory Board meeting on 24 April 2017 comprised operational topics and M&A transactions in addition to the financial data for Q1 and the outlook. Furthermore, Corporate Governance and Compliance topics as well as Audit and Risk Management were dealt with.

Among other things, the meeting on 20 July 2017 addressed the half-yearly financial data, the long term business plan of Telefónica Next with focus on Advanced Data Analytics and Internet of Things, the merger of Cash&Phone into Telefónica Germany GmbH & Co. OHG, Compliance topics as well as the efficiency of the Supervisory Board. Moreover, the meeting dealt with Management Board matters such as the early resignation of Rachel Empey with effect of 31 July 2017 and the appointment of the new Management Board members with effect of 1 August 2017.

The topics discussed at the meeting on 23 October 2017 included financial issues (especially the Q3 results and the business plan), the results of the Supervisory Board efficiency survey as well as the diversity concepts for Supervisory Board and Management Board. It was also agreed together with Management Board that the Annual General Meeting for the 2017 financial year would be held on 17 May 2018.

At the meeting on 18 December, mainly the budget for the financial year 2018 was approved.

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 2017, the Supervisory Board also held a strategy workshop together with the Management Board.

All Supervisory Board members in office for the entire 2017 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 2017 was passed this way – following appropriate preparation at presence meetings.

Committees of the Supervisory Board

The Supervisory Board has installed four committees: a Nomination Committee, a Mediation Committee, an Audit Committee and 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 assesses the necessary independence of the external auditor and is responsible for coordination with the external auditor. The Audit Committee consists of four members:

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

In 2017, the Audit Committee met five 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
- Julio Estéban Linares López (from 13 December 2017) and
- Marcus Thurand.

There was no need for the Mediation Committee to convene in the reported year.

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.

The Remuneration Committee met six times in the reporting period.

The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting.

The Nomination Committee has the following members:

- Patricia Cobián González (Chairperson)
- Eva Castillo Sanz
- Enrique Medina Malo.

In the reported year, the Nomination Committee prepared- by email resolution - the election proposal for the Annual General Meeting on 9 May 2017 for the regular election of the eight shareholder representatives.

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 315d in connection with 289f German Commercial Code in the Annual Report and on the company's website at www.telefonica.de/management-declaration-2017 and in the Corporate Governance Report on the company's website at www.telefonica.de/corporate-governance-report-2017.

On 20/21 July 2017 the Compliance Declaration approved on 13/14 and 17 October 2016 and published, updated on 11/12 December 2016 was updated and published again.

On 12/13/14 and 16 October 2017 the Management Board and the Supervisory Board approved a new Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG). The Declaration of Compliance was published on the company's website at www.telefonica.de/declaration-of-compliance-2017. Earlier versions of the Declaration of Compliance can be also found at the 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 % (during the financial year 2017: 31.25 % female members).

In the beginning of the financial year 2017, 50 % of the members of the Management Board were female. Since 1 August 2017, the quota is 25% (two members of the eight member Management Board are female), so the established gender diversity quota of at least 20 % for the members of the Management Board was exceeded. The quota of 25% determined on 18 December 2017 has also been met.

Review of the Financial Statements 2017

Pricewaterhouse Coopers GmbH Wirtschaftsprüfungsgesellschaft, audited the annual financial statements and the consolidated financial statements as well as the combined management report as of 31 December 2017 of Telefónica Deutschland Holding AG and the Group and provided each with an unqualified audit opinion. The annual financial statement of Telefónica Deutschland Holding AG and the combined management report for 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 315e 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 Telefónica Deutschland Holding AG and the Group, the separate non-financial declaration for Telefónica Deutschland for the financial year 2017 as well as 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 19 February 2018 ("Bilanzsitzung"). The Audit Committee and the full Supervisory Board thoroughly examined the Annual Financial Statement (Jahresabschluss), the Group financial statements, the combined Management Report for Telefónica Deutschland Holding AG and the Group, the separate non-financial declaration, the Management Board proposal for the distribution of profit and the respective auditor's reports and discussed the documents in detail together with the auditor on 19 February 2018.

The Supervisory Board approved the auditor's findings in the audit reports and had no objections after its own assessment.

At its meeting on 19 February 2018, 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 2017 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,

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 and discussed it with the auditor, the Supervisory Board had no objections against the dependency report and the Management Board's declaration on the relations to affiliated companies contained therein after the result of its own assessment and agrees with the auditor's findings.

The Supervisory Board thanks the former Management Board member Rachel Empey and the former Supervisory Board member Ángel Vilá Boix for the excellent and cooperative collaboration. The Supervisory Board also thanks Markus Haas, Markus Rolle, Wolfgang Metze, Alfons Lösing, Valentina Daiber, Nicole Gerhardt, Guido Eidmann, Cayetano Carbajo Martín and all employees of Telefónica Deutschland Group for their dedication and excellent work in the past year. With their commitment, which in the reporting period was influenced in particular by transformation, they have contributed considerably to the success of the company."

Munich, 19 February 2018

On behalf of the Supervisory Board



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