TELEFONICA S A
Form 6-K
March 21, 2013
Table of Contents

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16

of the Securities Exchange Act of 1934

For the month of March, 2013

Commission File Number: 001-09531

Telefónica, S.A.

(Translation of registrant s name into English)

Distrito Telefónica, Ronda de la Comunicación s/n,

28050 Madrid, Spain

3491-482 85 48

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F x Form 40-F ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes ¨ No x

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes ¨ No x

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes ¨ No x

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

Table of Contents

Telefónica, S.A.

TABLE OF CONTENTS

Table of Contents

Telefónica, S.A. hereby submits the Individual Annual Accounts of Telefónica, S.A. and the Consolidated Annual Accounts of Telefónica S.A. and its Group of Subsidiaries for 2012 financial year, that have been filed with the Spanish National Securities Market Commission (Comisión Nacional del Mercado de Valores CNMV).

The aforesaid Annual Accounts will be submitted for approval of the next Annual General Shareholders Meeting of the Company, the dates of which will be announced due course.

Madrid, March 21, 2013

Table of Contents

AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND

MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE

YEAR ENDED DECEMBER 31, 2012

Table of Contents

Audit Report

TELEFÓNICA, S.A.

Financial Statements and Management Report

for the year ended

December 31, 2012

Table of Contents

Translation of a report and financial statements originally issued in Spanish. In the event of

discrepancy, the Spanish-language version prevails (See Note 23)

AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of

Telefónica, S.A.

We have audited the financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2012, the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended. The Company s Directors are responsible for the preparation of the financial statements in accordance with the regulatory framework for financial information applicable to the entity in Spain (identified in Note 2.a to the accompanying financial statements), and specifically in accordance with the accounting principles and criteria contained therein. Our responsibility is to express an opinion on the aforementioned financial statements taken as a whole, based upon work performed in accordance with prevailing audit regulation in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the financial statements and the evaluation of whether their presentation, the accounting principles and criteria applied and the estimates made are in agreement with the applicable regulatory framework for financial information.

In our opinion, the accompanying 2012 financial statements give a true and fair view, in all material respects, of the equity and financial position of Telefónica, S.A. at December 31, 2012, and of the results of its operations and its cash flow for the year then ended, in conformity with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

The accompanying 2012 management report contains such explanations as the Directors consider appropriate concerning the situation of the Company, the evolution of its business and other matters; however, it is not an integral part of the financial statements. We have checked that the accounting information included in the aforementioned management report agrees with the 2012 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company s accounting records.

ERNST & YOUNG, S.L.

Ignacio Viota del Corte

March 20, 2013

Domicilio Social: Pl. Pablo Ruiz Picasso, 1. 28020 Madrid

Inscrita en el Registro Mercantil de Madrid al

Tomo 12749, Libro 0, Folio 215, Sección 8ª,

Hoja M-23123, Inscripción 116. C.I.F. B-78970506

Table of Contents

2012

TELEFÓNICA, S.A.

Annual financial statements and management report for the year ended December 31, 2012

Table of Contents

Index

Table of Contents

Table of Contents

2012 Financial Statements

Telefónica, S.A.

Balance sheet at December 31

Millions of euros	**Notes**	**2012**	**2011**
ASSETS			
NON-CURRENT ASSETS		**82,182**	**87,198**
Intangible assets	5	**64**	**68**
Patents, licences, trademarks and others		5	9
Software		15	11
Other intangible assets		44	48
Property, plant and equipment	6	**303**	**338**
Land and buildings		148	154
Plant and other PP&E items		115	141
Property, plant and equipment under construction and prepayments		40	43
Investment property	7	**410**	**423**
Land		65	65
Buildings		345	358
Non-current investments in Group companies and associates	8	**71,779**	**79,036**
Equity instruments		67,770	77,396
Loans to Group companies and associates		3,988	1,618
Other financial assets		21	22
Financial investments	9	**4,531**	**4,728**
Equity instruments		433	556
Loans to third parties		39	37
Derivatives	16	4,045	4,118
Other financial assets		14	17
Deferred tax assets	17	**5,095**	**2,605**
CURRENT ASSETS		**7,553**	**5,339**
Trade and other receivables	10	**1,065**	**698**
Current investments in Group companies and associates	8	**3,636**	**3,478**
Loans to Group companies and associates		3,608	3,390
Derivatives	16	2	57
Other financial assets		26	31
Investments	9	**390**	**394**

Loans to companies		9	46
Derivatives	16	282	348
Other financial assets		99	
Accruals		**12**	**4**
Cash and cash equivalents		**2,450**	**765**
TOTAL ASSETS		**89,735**	**92,537**

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

Table of Contents

2012 Financial Statements

Millions of euros	Notes	2012	2011
Equity and liabilities			
EQUITY		**22,978**	**26,597**
CAPITAL AND RESERVES		24,383	27,212
Share capital	11	**4,551**	**4,564**
Share premium	11	**460**	**460**
Reserves	11	**19,529**	**22,454**
Legal		984	984
Other reserves		18,545	21,470
Treasury shares and own equity instruments	11	**(788)**	**(1,782)**
Profit for the year	3	**631**	**4,910**
Interim dividend	3		**(3,394)**
UNREALIZED GAINS (LOSSES) RESERVE	11	(1,405)	(615)
Available-for-sale financial assets		(34)	(40)
Hedging instruments		(1,371)	(575)
NON-CURRENT LIABILITIES		**50,029**	**47,236**
Non-current provisions		**187**	**42**
Other provisions		187	42
Non-current borrowings	12	**13,274**	**11,339**
Bonds and other marketable debt securities	13	828	170
Bank borrowings	14	9,232	9,046
Derivatives	16	3,130	2,033
Finance leases		75	86
Other debts		9	4
Non-current borrowings from Group companies and associates	15	**36,069**	**35,381**
Deferred tax liabilities	17	**499**	**474**
CURRENT LIABILITIES		**16,728**	**18,704**
Current provisions		**8**	**65**
Current borrowings	12	**2,097**	**1,033**
Bonds and other marketable debt securities	13	828	87
Bank borrowings	14	1,145	742

Derivatives	16	124	204
Current borrowings from Group companies and associates	15	**14,181**	**17,140**
Trade and other payables	18	**439**	**440**
Accruals		**3**	**26**
TOTAL EQUITY AND LIABILITIES		**89,735**	**92,537**

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

Table of Contents

2012 Financial Statements

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2012	2011
Revenue	19	**5,817**	**7,952**
Rendering of services to Group companies and associates		687	707
Rendering of services to non-group companies		3	3
Dividends from Group companies and associates		4,852	6,967
Interest income on loans to Group companies and associates		275	275
Impairment and gains (losses) on disposal of financial instruments	19	**(5,311)**	**(1,082)**
Impairment losses and other losses	8	(5,312)	(1,606)
Gains (losses) on disposal and other gains and losses		1	524
Other operating income	19	**120**	**157**
Non-core and other current operating revenue - Group companies and associates		95	140
Non-core and other current operating revenue - non-group companies		25	17
Employees benefits expense	19	**(141)**	**(244)**
Wages, salaries and others		(130)	(213)
Social security costs		(11)	(31)
Other operational expense		**(500)**	**(399)**
External services - Group companies and associates	19	(99)	(94)
External services - non-group companies	19	(389)	(296)
Taxes other than income tax		(12)	(9)
Depreciation and amortization	5, 6 and 7	**(63)**	**(72)**
Gains (losses) on disposal of fixed assets		**(1)**	**1**
OPERATING PROFIT		**(79)**	**6,313**
Finance revenue	19	**213**	**139**
From equity investments of third parties		17	38
From marketable securities and other financial instruments of third parties		196	101
Finance costs	19	**(2,268)**	**(2,119)**
Borrowings from Group companies and associates		(2,042)	(1,872)
Third-party borrowings		(226)	(247)

Change in fair value of financial instruments		**(59)**	**(91)**
Trading portfolio and other securities		(4)	(11)
Gain (loss) on available-for-sale financial assets recognized in the period	9	(55)	(80)
Exchange rate gains (losses)	19	**41**	**(138)**
Impairment and gains (losses) on disposal of financial instruments with third-parties	19	**(53)**	**(105)**
NET FINANCIAL EXPENSE		**(2,126)**	**(2,314)**
PROFIT BEFORE TAX	21	**(2,205)**	**3,999**
Income tax	17	**2,836**	**911**
PROFIT FOR THE YEAR		**631**	**4,910**

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

Statements of changes in equity for the years ended December 31

A) Statement of recognized income and expense

Millions of euros	Notes	2012	2011
Profit of the period		**631**	**4,910**
Total income and expense recognized directly in equity	**11**	**(950)**	**(612)**
From measurement of available-for-sale financial assets		(46)	(50)
From cash flow hedges		(1,310)	(824)
Income tax impact		406	262
Total amounts transferred to income statement	**11**	**160**	**147**
From measurement of available-for-sale financial assets		55	
From cash flow hedges		173	210
Income tax impact		(68)	(63)
TOTAL RECOGNIZED INCOME AND EXPENSE		**(159)**	**4,445**

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

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

Millions of euros	Share capital	Share premium	Reserves	Treasury shares and own equity investments	Profit for the year	Interim dividend	Net unrealized gains (losses) reserve	Total
Balance at December 31, 2010	**4,564**	**460**	**24,710**	**(1,376)**	**4,130**	**(2,938)**	**(150)**	**29,400**
Total recognized income and expense					4,910		(465)	4,445
Transactions with shareholders and owners			(3,455)	(777)		(3,394)		(7,626)
Capital decreases								
Dividends paid			(3,458)			(3,394)		(6,852)
Transactions with treasury shares or own equity instruments (net)			3	(777)				(774)
Other movements			7	371				378
Appropriation of prior year profit (loss)			1,192		(4,130)	2,938		
Balance at December 31, 2011	**4,564**	**460**	**22,454**	**(1,782)**	**4,910**	**(3,394)**	**(615)**	**26,597**
Total recognized income and expense					631		(790)	(159)
Transactions with shareholders and owners	(13)		(4,497)	972				(3,538)
Capital decreases	(84)		(1,237)	1,321				
Dividends paid	71		(2,907)					(2,836)
			(353)	(349)				(702)

Transactions with treasury shares or own equity instruments (net)								
Other movements			56	22				78
Appropriation of prior year profit (loss)			1,516		(4,910)	3,394		
Balance at December 31, 2012	**4,551**	**460**	**19,529**	**(788)**	**631**		**(1,405)**	**22,978**

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

Table of Contents

2012 Financial Statements

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	**Notes**	**2012**	**2011**
A) CASH FLOWS FROM OPERATING ACTIVITIES		**1,981**	**6,423**
Profit before tax		**(2,205)**	**3,999**
Adjustments to profit:		**2,519**	**(3,773)**
Depreciation and amortization	5, 6 and 7	63	72
Impairment of investments in Group companies and associates	8	5,312	1,606
Change in long term provisions		145	
Gains on the sale of financial assets		(1)	(524)
Losses on disposal of property, plant and equipment		1	1
Dividends from Group companies and associates	19	(4,852)	(6,967)
Interest income on loans to Group companies and associates	19	(275)	(275)
Net financial expense	19	2,126	2,314
Change in working capital		**(165)**	**(108)**
Trade and other receivables		45	(51)
Other current assets		(35)	(16)
Trade and other payables		(73)	(106)
Other current liabilities		(102)	65
Other cash flows from operating activities	21	**1,832**	**6,305**
Net interest paid		(2,007)	(1,405)
Dividends received		3,337	7,073
Income tax receipts		502	637
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES		**1,372**	**(1,235)**
Payments on investments	21	(6,779)	(3,554)
Proceeds from disposals	21	8,151	2,319
C) CASH FLOWS USED IN FINANCING ACTIVITIES		**(1,663)**	**(4,817)**
Payments on equity instruments	11	(590)	(377)
Proceeds from financial liabilities	21	1,763	2,412
Debt issues		10,964	7,533
Repayment and redemption of debt		(9,201)	(5,121)
Dividends paid	11	(2,836)	(6,852)
D) NET FOREIGN EXCHANGE DIFFERENCE		**(5)**	**(22)**
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**1,685**	**349**
Cash and cash equivalents at January 1		765	416
Cash and cash equivalents at December 31		2,450	765

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

TELEFÓNICA, S.A.

Annual financial statements and management report for the ended December 31, 2012

Note 1. Introduction and general information

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

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

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

In keeping with the above, Telefónica is currently the parent company of a group that operates mainly in the telecommunications, media and entertainment industries, providing a wide range of services on the international stage.

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

Note 2. Basis of presentation

a) True and fair view

These financial statements have been prepared from Telefónica, S.A. s accounting records by the Company s Directors in accordance with the accounting principles and standards contained in the Code of Commerce, developed in the Spanish GAAP in force (2007 Spanish GAAP) and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company s equity, financial position, results of operations and of the cash flows obtained and applied in 2012.

The accompanying financial statements for the year ended December 31, 2012 were prepared by the Company s Board of Directors at its meeting on February 27, 2013 for submission for approval at the General Shareholders Meeting, which is expected to occur without modification.

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

b) Comparison of information

In 2011 and 2012 there have not been significant transactions that should be taken into account in order to ensure the comparison of information included in the Annual Financial Statements of both years.

c) Use of estimates

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

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

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

Provisions for impairment of investments in Group companies, joint ventures and associates

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

Recoverable amount of investments in group companies, joint ventures and associates is measured as described in Note 4.e.

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

Deferred taxes

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Company s ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

The appropriate classification of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

Note 3: Proposed appropriation of profit

Telefónica, S.A. obtained 631 million euros of profit in 2012. Accordingly, the Company s Board of Directors will submit the following proposed appropriation of 2012 profit for approval at the Shareholders Meeting:

Millions of euros	
Proposed appropriation:	
Profit for the year	631
Distribution to:	
Goodwill reserve (Note 11.c)	2
Voluntary reserves	629

Note 4. Recognition and measurement accounting policies

The main recognition and measurement accounting policies applied in the preparation of the 2012 annual financial statements are the following:

a) Intangible assets

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

The useful lives of intangible assets are assessed individually to be either finite or indefinite. Intangible assets with finite lives are amortized systematically over the useful economic life and assessed for impairment whenever events or changes indicate that their carrying amount may not be recoverable.

Amortization methods and schedules are revised annually at year end and, where appropriate, adjusted prospectively.

Intangible assets include mainly the following:

1. Computer software licenses, which are recorded at cost and amortized on a straight-line basis over their useful lives, generally estimated at three years.

2. Intellectual property, which is recorded at the amounts paid to acquire ownership of or rights to use patents and trademarks and amortized on a straight-line basis over the useful life of the patent or trademark for a period of 3 to 10 years.

3. The goodwill arising from the merger of Telefónica, S.A. and Terra Networks, S.A. carried out in 2005. This is included under Other intangible assets at the carrying amount at January 1, 2008 of 33 million euros, calculated in accordance with the former accounting principles, less any accumulated impairment losses. Goodwill is not amortized, but is tested for impairment annually or more frequently if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable (see Note 4.c).

b) Property, plant and equipment and investment property

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value. Land is not depreciated.

Cost includes external costs plus any internal costs comprising warehouse materials used, direct labor costs incurred in installation work and the allocable portion of the indirect costs required for the related investment. Cost includes, where appropriate, the initial estimate of decommissioning, retirement and site reconditioning costs when the Company is under obligation to incur such costs due to the use of the asset.

Costs incurred for expansion, remodeling or improvements which increase the productivity, capacity, or prolong the useful life of the asset are capitalized when the capitalization requirements are met.

Interest and other borrowing costs incurred and directly attributable to the acquisition or construction of assets that require preparation of more than one year for their intended use or sale are capitalized.

Upkeep and maintenance expenses are expensed as incurred.

The Company assesses the need to write down, if appropriate, the carrying amount of each item of property, plant and equipment to its recoverable amount whenever there are indications that the assets carrying amount exceeds the higher of its fair value less costs to sell or its value in use. The impairment provision is not maintained if the factors giving rise to the impairment disappear (see Note 4.c).

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

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

Assets estimated residual values and methods and depreciation periods are reviewed, and adjusted if appropriate, prospectively at each financial year end.

Investment property is measured using the same criteria described for land and buildings for own use. Buildings included in investment property are depreciated on a straight-line basis over a period of up to 40 years.

c) Impairment of non-current assets

Non-current assets are assessed at each reporting date for indications of impairment. Where such indications exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset s recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value in the currency in which they will be generated, using a discount rate appropriate to that currency and reflecting current market assessments of the time value of money and the risks specific to the asset. The Company translates that present value into its accounting currency at the exchange rate prevailing at the close of the day of calculation of value in use. When the carrying amount of an asset exceeds its recoverable amount, the asset is considered to be impaired. In this case, the carrying amount is written down to recoverable amount and the resulting loss is taken to the income statement. Future depreciation or amortization charges are adjusted for the asset s new carrying amount over its remaining useful life. The Company assesses each asset individually for impairment, unless the asset does not generate cash inflows that are largely independent of those from other assets (or cash-generating units).

The Company bases the calculation of impairment on the business plans of the various cash-generating units to which the assets are allocated. These business plans generally cover a period of five years. For periods beyond the strategic plan, an expected constant or decreasing growth rate is applied to the projections based on these plans from the fifth year.

When there are new events or changes in circumstances that indicate that a previously recognized impairment loss no longer exists or has been decreased, a new estimate of the asset s recoverable amount is made. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset s recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The reversal is limited to the net carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the income statement and the depreciation charge is adjusted in future periods to the asset s revised carrying amount.

d) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the agreement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the Company to use the asset.

Leases where the lessor does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased item to the Company. These are classified at the inception of the lease, in accordance with its nature and the associated liability, at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance costs and reduction of the principal of lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are taken to the income statement over the lease term.

e) Financial assets and liabilities

Financial investments

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset. The Company classifies its financial assets into the following categories for initial recognition purposes: financial assets held for trading, other financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, investments in Group companies, joint ventures and associates, and available-for-sale financial assets. When appropriate, the Company re-evaluates the designation at each financial year end.

Financial assets held for trading, i.e., investments made with the aim of realizing short-term profits as a result of price changes, are included in Financial assets held for trading and presented under current or non-current assets depending on their maturity. Derivatives are classified as held for trading unless they are designated as effective hedging instruments.

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

Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest rate movements and which have not been included in the preceding categories are classified as available-for-sale. These investments are recorded under Non-current assets, unless it is probable and feasible that they will be sold within 12 months. Financial assets in this category are measured at fair value. Gains or losses arising from changes in fair value are recognized in equity until the asset is derecognized or impaired, at which time the cumulative gain or loss previously reported in equity is taken to the income statement. Dividends from available-for-sale equity investments are recognized in the income statement once the Company has the right to receive the dividend. In addition, interests, calculated using the effective interest rate model, are recognized in the income statement. Fair value is determined in accordance with the following criteria:

1. Listed securities on active markets: Fair value is considered to be the quoted market price at the closing date.

2. Unlisted securities: Fair value is determined using valuation techniques such as discounted cash flow analysis, option valuation models, or by reference to arm s length market transactions. Exceptionally, with equity instruments, when fair value cannot be reliably determined, the investments are carried at cost.

Loans and receivables includes trade or non-trade financial assets, that are neither derivatives nor equity instruments, with fixed or determinable payments and that are not quoted in an active market and not included in any of the preceding classifications. Upon initial recognition, these assets are recognized at fair value which, unless there is evidence to the contrary, is the transaction price, which is equivalent to the fair value of the consideration paid plus directly attributable transaction costs. Following initial recognition, these financial assets are measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the loans and receivables are settled or impaired, as well as through the amortization process. Trade receivables are recognized at the original invoice amount. A valuation adjustment is recorded when there is objective evidence of customer collection risk. The amount of the valuation adjustment is calculated as the difference between the carrying amount of the doubtful trade receivables and their recoverable amount. As a general rule, current trade receivables are not discounted, unless the effect of such discount is material.

The Group assesses at each reporting date whether a financial asset is impaired. If there is objective evidence that an impairment loss on a financial asset carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset s carrying amount and its recoverable value, calculated as the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset s original effective interest rate. If in a subsequent period the impairment loss decreases as a result of a subsequent event, the loss is reversed, with the asset s amortized cost had no impairment loss been recognized as the upper limit.

Such a reversal is recognized in the income statement of that year.

For instruments recognized as available-for-sale financial assets, the Company assesses individually for each security whether there is any objective evidence that an asset is impaired as a result of one or more events indicating that the carrying amount of the security will not be recovered. If there is objective evidence that an available-for-sale financial instrument is impaired, the cumulative loss recognized in equity measured as the difference between the acquisition cost (net of any principal payments and amortization made) and the current fair value, less any impairment loss on that investment previously recognized in the income statement, is removed from equity and recognized in the income statement. If in a subsequent period the fair value of the financial asset increases because of a subsequent event, the impairment loss is reversed through the income statement if the asset is a debt instrument. For equity instruments, the loss is not reversed in the income statement for the period, but rather in equity, as the instrument is measured at its new fair value, with any changes taken to equity.

Recoverable amount for estimating impairment of investments in group companies, joint ventures and associates is the higher of the investment s fair value less costs to sell and the present value of the future cash flows derived from the investment. These cash flows can be calculated by estimating the cash flows to be received from dividends or from the disposal or derecognition of the investment, or the Company s share of the cash flows expected to be generated by the investment (from operations, or the investment s disposal or derecognition).

Financial assets are only fully or partially derecognized when:

1. The rights to receive cash flows from the asset have expired.

2. The Company has transferred its rights to receive cash flows from the asset to a third party and transferred substantially all the risks and rewards of the asset.

Cash and cash equivalents

Cash and cash equivalents included on the balance sheet include cash on hand and at banks, demand deposits and other highly liquid investments with an original maturity of three months and limited risk of changes in their value. These items are stated at historical cost, which does not differ significantly from realizable value.

For the purpose of the cash flow statement, cash and cash equivalents are shown net of any outstanding bank overdrafts.

Issues and interest-bearing debt

These debts are recognized initially at the fair value which, unless there is evidence to the contrary, is the transaction price less directly attributable transaction costs. After initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method. Any difference between the cash received (net of transaction costs) and the repayment value is recognized in the income statement over the life of the debt. Interest-bearing debt is considered non-current when its maturity is over 12 months or the Company has full discretion to defer settlement for at least another 12 months from the reporting date.

Financial liabilities are derecognized when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced with another on substantially different terms, such an exchange is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in their respective carrying amounts is taken to the income statement.

Derivative financial instruments and hedge accounting

Derivative financial instruments are initially recognized at fair value, normally equivalent to cost. Their carrying amounts are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. They are classified as current or non-current depending on whether they fall due within less than or after one year, respectively. Derivatives that meet all the criteria for consideration as long-term hedging instruments are recorded as non-current assets when fair value is positive and non-current liabilities when fair value is negative.

The accounting treatment of any gain or loss resulting from changes in the fair value of a derivative depends on whether the derivative in question meets all the criteria for hedge accounting and, if appropriate, on the nature of the hedge.

The Company designates certain derivatives as:

1. Fair value hedges, when hedging the exposure to changes in the fair value of a recognized asset or liability or a firm transaction;

2. Cash flow hedges, when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction; or

3. Hedges of a net investment in a foreign operation.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value or a cash flow hedge.

Changes in fair value of derivatives that qualify as fair value hedges are recognized in the income statement, together with changes in the fair value of the hedged item attributable to the risk hedged.

Changes in the fair value of derivatives that qualify and have been assigned to hedge cash flows, which are highly effective, are recognized in net equity. The portion considered ineffective is taken directly to the income statement. Fair value changes from hedges that relate to firm commitments or forecast transactions that result in the recognition of non-financial assets or liabilities are included in the initial measurement of those assets or liabilities. Otherwise, changes in fair value previously recognized in equity are recognized in the income statement in the period in which the hedged transaction affects profit or loss.

An instrument designed to hedge foreign currency exposure on a net investment in a foreign operation is accounted for in a way similar to foreign currency fair value hedges. For these purposes, the net investment in the foreign operation comprises not only the share in the equity of the foreign investment, but also the monetary item receivable or payable, the settlement of which is not expected or likely to take place in the foreseeable future, excluding trade items.

The application of the Company s corporate risk-management policies could result in financial risk-hedging transactions that make economic sense, yet do not comply with the criteria and effectiveness tests required by accounting policies to be treated as hedges. Alternatively, the Company may opt not to apply hedge accounting criteria in certain instances. In these cases, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

From inception, the Company formally documents the hedge relationship between the derivative and the hedged item, as well as the associated risk management objectives and strategies. The documentation includes identification of the hedge instrument, the hedged item or transaction and the nature of the risk being hedged. In addition, it states how it will assess the hedging instrument s effectiveness in offsetting the exposure to changes in the hedged item s fair value or cash flows attributable to the hedged risk. Hedge effectiveness is assessed, prospectively and retrospectively, both at the inception of the hedge relationship and on a systematic basis throughout the life of the hedge.

Hedge accounting is discontinued whenever the hedging instrument expires or is sold, terminated or settled, the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation. In these instances, gains or losses accumulated in equity are not taken to the income statement until the forecast transaction or commitment affects profit or loss. However, if the hedged transaction is no longer expected to occur, the cumulative gains or losses recognized directly in equity are taken immediately to the income statement.

The fair value of the unquoted derivatives portfolio includes estimates based on calculations using observable market data, as well as specific pricing and risk-management tools commonly used by financial entities.

f) Treasury shares

Treasury shares are stated at cost and deducted from equity. Any gain or loss obtained on the purchase, sale, issue or cancellation of treasury shares is recognized directly in equity.

Call options on treasury shares to be settled through the physical delivery of a fixed number of shares at a fixed price are considered treasury share instruments. They are valued at the amount of premium paid and are presented as a reduction in equity. If the call options are exercised upon maturity, the amount previously recognized is reclassified as treasury shares together with the price paid. If the call options are not exercised, their value is recognized directly in equity.

g) Foreign currency transactions

Monetary and non-monetary items denominated in foreign currencies are translated to euros at the exchange rates prevailing on the related transaction date, and are retranslated at year end to the exchange rates then prevailing.

All realized or unrealized exchange gains or losses are taken to the income statement for the year, with the exception of non-monetary items measured at fair value, provided that they are recognized directly in equity (such as investments in equity instruments classified as available-for-sale financial assets). In these cases, any exchange differences included in gains or losses recognized in equity derived from changes in the value of the non-monetary items measured at fair value are also recognized directly in equity.

h) Provisions

Pensions and other employee obligations

The Company has a defined-contribution pension plan for employees. The obligations are limited to the regular payment of the contributions, which are taken to the income statement as incurred.

Other provisions

Provisions are recognized when the Company has a present obligation (legal or constructive), as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted, and the corresponding increase in the provision due to the passage of time is recognized as a finance cost.

i) Share-based payments

For equity-settled share option plans, fair value at the grant date is measured by applying statistical techniques or using benchmark securities. The cost is recognized, together with a corresponding increase in equity, over the vesting period. At each subsequent reporting date, the Company reviews its estimate of the number of options it expects to vest, with a corresponding adjustment to equity.

j) Income tax

The income tax expense of each year includes both current and deferred taxes, where applicable.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred income tax is provided using the balance sheet liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts.

The main temporary differences arise due to discrepancies between the tax bases and accounting amounts of investments in Group companies and associates.

Furthermore, deferred taxes arise from the carryforward of unused tax credits and unused tax losses.

The Company determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability settled, based on tax rates and tax laws that are enacted (or substantively enacted) at the reporting date.

Deferred income tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred income tax relating to items directly recognized in equity is recognized in equity.

k) Revenue and expenses

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

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

l) Related party transactions

Related party transactions are accounted for in accordance with the criteria described above.

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

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

The effective date of mergers and spin-offs for accounting purposes is taken as the first day of the year in which the merger or spin-off was approved, to the extent that it falls after the companies were incorporated into the group. If one of the companies joins the group in the year of the merger or spin-off, the acquisition date is used for accounting purposes.

m) Financial guarantees

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

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

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

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

o) Consolidated data

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group s consolidated financial statements for 2012 and 2011 are as follows:

Millions of euros	2012	2011

Item		
Total assets	129,773	129,623
Equity:		
Attributable to equity holders of the parent	20,461	21,636
Attributable to minority interests	7,200	5,747
Revenue from operations	62,356	62,837
Profit for the year:		
Attributable to equity holders of the parent	3,928	5,403
Attributable to minority interests	475	784

Note 5. Intangible assets

The movements in the items composing intangible assets and the related accumulated amortization in 2012 and 2011 are as follows:

2012 Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	**320**	**15**	**(7)**	**3**	**331**
Patents, licenses, trademarks, and others	29	1	(5)	1	26
Software	173	11	(2)	2	184
Other intangible assets	118	3			121
ACCUMULATED AMORTIZATION	**(252)**	**(17)**	**2**		**(267)**
Patents, licenses, trademarks, and others	(20)	(2)	1		(21)
Software	(162)	(8)	1		(169)
Other intangible assets	(70)	(7)			(77)
Net carrying amount	**68**	**(2)**	**(5)**	**3**	**64**

2011 Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	**311**	**5**	**(11)**	**15**	**320**
Patents, licenses, trademarks, and others	22	2		5	29
Software	176	3	(11)	5	173
Other intangible assets	113			5	118
ACCUMULATED AMORTIZATION	**(240)**	**(22)**	**10**		**(252)**
Patents, licenses, trademarks, and others	(18)	(2)			(20)
Software	(162)	(10)	10		(162)
Other intangible assets	(60)	(10)			(70)
Net carrying amount	**71**	**(17)**	**(1)**	**15**	**68**

As of April 1st, 2012 Telefónica, S.A. transferred its digital business unit to Telefónica Digital España, S.L. Due to this operation the Company has registered disposals of software shown in the chart above.

Disposals in 2011 were related to sales of software, at carrying amount, to other Telefónica Group companies.

At December 31, 2012 and 2011 commitments exist to acquire intangible assets amounting to 1 million euros in both years. Future finance lease commitments are also disclosed in Note 19.5.

At December 31, 2012 and 2011, the Company had 223 million euros and 190 million euros, respectively, of fully amortized intangible assets.

Table of Contents

Note 6. Property, plant and equipment

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2012 and 2011 are as follows:

2012 Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	**594**	**7**	**(4)**	**(5)**	**592**
Land and buildings	228			(1)	227
Plant and other PP&E items	323	3	(2)	1	325
Property, plant and equipment under construction and prepayments	43	4	(2)	(5)	40
ACCUMULATED DEPRECIATION	**(256)**	**(37)**	**2**	**2**	**(289)**
Buildings	(74)	(5)			(79)
Plant and other PP&E items	(182)	(32)	2	2	(210)
Net carrying amount	**338**	**(30)**	**(2)**	**(3)**	**303**

2011 Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	**598**	**12**	**(1)**	**(15)**	**594**
Land and buildings	219	1		8	228
Plant and other PP&E items	305	9	(1)	10	323
Property, plant and equipment under construction and prepayments	74	2		(33)	43
ACCUMULATED DEPRECIATION	**(217)**	**(40)**	**1**		**(256)**
Buildings	(69)	(5)			(74)
Plant and other PP&E items	(148)	(35)	1		(182)
Net carrying amount	**381**	**(28)**		**(15)**	**338**

Firm commitments to acquire property, plant and equipment at December 31, 2012 and 2011 amounted to 1 million euros and 0.4 million euros, respectively.

In 2012 and 2011, no interest or other borrowing costs incurred in the construction of property, plant and equipment were capitalized.

At December 31, 2012 and 2011, the Company had 42 million euros and 36 million euros, respectively, of fully depreciated items of property, plant and equipment.

Table of Contents

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

Property, plant and equipment includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 78 million euros and 79 million euros at the 2012 and 2011 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) of 88 and 114 million euros at December 31, 2012 and 2011, respectively. The land and buildings rented to other Group Companies have been included as Investment properties in Note 7.

Note 7. Investment properties

The movements in the items composing investment properties in 2012 and 2011 and the related accumulated depreciation are as follows:

	2012				
Millions of euros	**Opening balance**	**Additions and allowances**	**Disposals**	**Transfers**	**Closing balance**
INVESTMENT PROPERTIES, GROSS	**474**		**(4)**		**470**
Land	65				65
Buildings	409		(4)		405
ACCUMULATED DEPRECIATION	**(51)**	**(9)**			**(60)**
Buildings	(51)	(9)			(60)
Net carrying amount	**423**	**(9)**	**(4)**		**410**

	2011				
Millions of euros	**Opening balance**	**Additions and allowances**	**Disposals**	**Transfers**	**Closing balance**
INVESTMENT PROPERTIES, GROSS	**386**	**88**			**474**
Land	65				65
Buildings	321	88			409
ACCUMULATED DEPRECIATION	**(41)**	**(10)**			**(51)**
Buildings	(41)	(10)			(51)
Net carrying amount	**345**	**78**			**423**

In January 2011, the Telefónica Group completed the move to Diagonal 00 building, its new corporate headquarters in Barcelona. The building has been accounted for as an asset acquired under a finance lease. It is accordingly shown under Additions in the table of 2011 at the present value of the rental payments, 88 million euros. 100% of this space is rented to Telefónica Group companies under 15-year non-cancellable lease contracts that can be renewed for up to 50 years at the discretion of Telefónica. In 2012 the present value of the rentals has been reestimated and the value has been impaired in 4 million euros shown as Disposals in the table above. The maturity calendar of the future minimum payments is as follows:

Millions of euros	**Future minimum payments**
Up to one year	5
Between one and five years	21
Over 5 years	49
Total	**75**

In addition to the "Diagonal 00" building mentioned above, "Investment properties" mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the Distrito Telefónica head offices in Madrid.

The Company has buildings with a total area of 332,291 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 93.45% of the buildings it has earmarked for lease. In 2011, it had a total of 367,167 square meters leased, equivalent to an occupancy rate of 93.3% of the buildings earmarked for lease.

Total income from leased buildings in 2012 (see Note 19.1) amounted to 50 million euros (52 million euros in 2011). Future minimum rentals receivable under non-cancellable leases are as follows:

Millions of euros	2012 Future minimum recoveries	2011 Future minimum recoveries
Up to one year	51	51
Between one and five years	134	121
Over 5 years		5
Total	**185**	**177**

All lease contracts held with subsidiaries occupying Distrito Telefónica premises expired in 2010. These contracts were renewed in 2011, for a non-cancellable period of three years. The figures for 2011 also reflect non-cancellable lease revenue from Diagonal 00, the contracts for which expire in 2016.

The main contracts in which Telefónica, S.A. acts as lessee are described in Note 19.5.

Table of Contents

Note 8. Investments in group companies and associates

8.1. The movements in the items composing investments in Group companies, joint ventures and associates in 2012 and 2011 are as follows:

	2012								
Millions of euros	**Opening balance**	**Additions**	**Disposals**	**Transfers**	**Exchange losses**	**Dividends**	**Hedges of a net investment**	**Closing balance**	**Fair value**
Non-current:									
Equity instruments (Net) (1)	77,396	(2,439)	(7,311)	27		(30)	127	67,770	128,574
Equity instruments (Cost)	86,956	2,873	(7,421)	27		(30)	127	82,532	
Impairment losses	(9,560)	(5,312)	110					(14,762)	
Loans to Group companies and associates	1,618	786	(9)	1,593				3,988	4,051
Other financial assets	22	21		(22)				21	21
Total non-current investment in Group companies and associates	**79,036**	**(1,632)**	**(7,320)**	**1,598**		**(30)**	**127**	**71,779**	**132,646**
Current									
Loans to Group companies and associates	3,390	3,249	(1,479)	(1,620)	68			3,608	3,624
Derivates	57	4	(59)					2	2
Other financial assets	31	10	(37)	22				26	26
Total current investments in Group companies and associates	**3,478**	**3,263**	**(1,575)**	**(1,598)**	**68**			**3,636**	**3,652**

(1) Fair value at December 31, 2012 of Group companies and associates quoted in an active market (Telefónica Brasil, S.A. and Telefónica Czech Republic, a.s.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities business plans.

Table of Contents

Millions of euros	2011 Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Non-current:									
Equity instruments (Net) (1)	78,870	(1,148)	(404)	123		(113)	68	77,396	139,678
Equity instruments (Cost)	86,824	458	(404)	123		(113)	68	86,956	
Impairment losses	(7,954)	(1,606)						(9,560)	
Loans to Group companies and associates	2,832	149	(31)	(1,322)	(10)			1,618	1,681
Other financial assets	24	25		(27)				22	22
Total non-current investment in Group companies and associates	**81,726**	**(974)**	**(435)**	**(1,226)**	**(10)**	**(113)**	**68**	**79,036**	**141,381**
Current									
Loans to Group companies and associates	3,295	750	(1,856)	1,322	(121)			3,390	3,467
Derivates	12	57	(12)					57	57
Other financial assets	28	9	(33)	27				31	31
Total current investments in Group companies and associates	**3,335**	**816**	**(1,901)**	**1,349**	**(121)**			**3,478**	**3,555**

(1) Fair value at December 31, 2011 of Group companies and associates quoted in an active market (Telefónica de Peru, S.A.A. Telefónica Brasil, S.A. and Telefónica Czech Republic, a.s.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities business plans.

2012

In April, 2012, Telefónica Móviles Colombia, S.A. (a company fully owned by the Telefónica Group), the Colombian government (hereinafter the Government) and Colombia Telecomunicaciones, S.A. ESP (a company 52% owned by Telefónica Group and 48% by the Government) reached a final agreement to restructure their wireline and wireless businesses in Colombia. The agreement led to the merger between Colombia Telecomunicaciones, S.A. ESP and Telefónica Móviles Colombia, S.A., resulting in Telefónica holding 70% of the share capital of the resulting company and the Government the remaining 30%, based on the valuations of the companies used to determine said shareholdings. Telefónica, S.A. held a direct shareholding of 49.42% in Telefónica Móviles Colombia, S.A., holding 18.51% of the merged company after the merger. This transaction did not alter the cost of the investment held by the Company.

Telefónica started to reorganize its business in Latin America during 2012. As part of this process, on October 10, 2012 and November 7, 2012 two new companies, Telefónica América, S.A. and Telefónica Latinoamérica Holding, S.L., were incorporated, both of which are jointly controlled by Telefónica, S.A. and Telefónica Internacional, S.A.U. On December 13, 2012, Telefónica Latinoamérica Holding, S.L. performed two consecutive capital increases. In the first, Telefónica, S.A. contributed its shareholding in Latin American Cellular Holdings, B.V. at its carrying amount of 1,749 million euros. In the second, Telefónica Internacional, S.A.U. contributed 100 million euros in cash. Telefónica, S.A. a held 94.59% in this company subsequent to the capital increase. This shareholding contribution is not shown in the table of movements attached. In addition, on December 18, 2012, Telefónica, S.A. sold its non-controlling interest in Telefónica de Perú,S.A.A. to Telefónica Latinoamérica Holding, S.L. for 4 million euros. The share transfer was performed at the price quoted on the Peruvian stock market of 2.3 PEN per share, and gave rise to gains of 1 million euros, recognized under the income statement caption Gains (losses) on disposal and other gains and losses . This transaction is recognized under Others in the Disposals of investments table in section b) of this Note.

Telefónica has also commenced the reorganization of its subsidiaries in Chile. During the first quarter of 2012, Inversiones Telefónica Móviles Holding, Ltd. distributed a dividend in kind comprising the shareholding in Inversiones Telefónica Fija, S.A. at its net carrying amount totaling 67 million euros. This contribution is reflected as an addition in the table of movements for 2012. Meanwhile, on November 19, 2012, Telefónica Chile Holdings, B.V. was incorporated with share capital of 1 euro. On December 10, 2012, it increased its share capital, which was subscribed by the Company in exchange for the Company s shareholding in Inversiones Telefónica Fija, S.A. Finally, on December 24, 2012, Telefónica Chile Holdings, B.V. increased its share capital, subscribed in full by Telefónica, S.A. for 405 million euros, paid in cash. This capital increase involving a shareholding contribution is not shown in the table of movements attached, whereas that involving the cash payment is shown under Additions.

Transfers in 2012 include the capitalization of the participative loan awarded to Telefónica Digital España, S.L. and amounting to 27 million euros.

Movement in Transfers under Loans to Group companies and associates primarily relates to the reclassification from non-current to current, in accordance with the loan maturity schedule.

The column headed Dividends sets out the amounts of dividends paid out by Group companies and associates in respect of earnings generated prior to the effective date of the corresponding shareholding. Dividends comprise those distributed by Telefónica Czech Republic, a.s. totalling 30 million euros in 2012, and mainly by Sao Paulo Telecommunicaçoes (107 million euros) in 2011.

The impact in 2012 of hedges of net investments in foreign operations amounted to a gain of 127 million euros (68 million euros in 2011).

2011

On March 25, 2011 the Boards of Directors of each of the subsidiaries controlled by Telefónica, Vivo Participações and Telesp, approved the terms and conditions of a restructuring process whereby all shares of Vivo Participações that were not owned by Telesp were exchanged for Telesp shares, at a rate of 1.55 new Telesp shares for each Vivo Participações share. These shares then became the property of Telesp, whereby Vivo Participações then became a wholly owned subsidiary of Telesp. The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders´ Meeting held on the same date following authorization by the Brazilian telecommunications regulator, Anatel.

At that date, Telefónica, S.A. held a direct stake of approximately 60% in Vivo Participaçoes, Ltda., valued at 13,021 million euros, subsequent to the liquidation by absorption of Portelcom Participaçoes, S.A., PTelecom Brasil, S.A. and Telefónica Brasil Sul Celular Participaçoes, Ltda.

The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders Meeting held on the same date.

Following the share exchange, a partial contribution was made to Sao Paulo Telecommunicaçoes (SPT), leaving the direct stake in Telesp at 24.68%. As all the aforementioned transactions were performed at the carrying amounts, they are not reflected in the table of movements for 2011.

On June 14, 2011, the Boards of Directors of Vivo Participações and Telesp approved a restructuring plan whose objective was to simplify the corporate structure of both companies and foster their integration, eliminating Vivo Participações from the corporate chain through the incorporation of its total equity into Telesp, and concentrating all mobile telephony activities in Vivo, S.A. (now a direct subsidiary of Telesp).

This deal was submitted for consideration by the Brazilian telecommunications regulator and finally approved at the General Shareholders Meetings of both companies on October 3, 2011. The company arising from the merger changed its name to Telefónica Brasil, S.A.

In 2011, Transfers primarily reflected capitalization on June 15, 2011 and September 12, 2011 of accrued interest receivable on loans granted to Telefónica Móviles México, S.A. de C.V., amounting to 32 million euros (541 million Mexican pesos) and 30 million euros (524 million Mexican pesos), respectively.

In January and October 2011, rights to collection from Telcel, C.A. were contributed to Latin American Cellular Holding, S.A., so that the latter could offset them against the loan it had received from the former. These contributions amounted to 61 million euros, as reflected under Transfers.

In 2012 and 2011, Telefónica, S.A. bought and sold the following shareholdings:

a) Acquisitions of investments and capital increases:

Millions of euros **Companies**	**2012**	**2011**
Telfin Ireland, Ltd.	1,081	
Telfisa Global, B.V.	703	
Telefónica Chile Holdings, B.V.	405	
Telco, S.p.A.	277	
Casiopea Re, S.A.		80
Telefónica Global Technology, S.A.U.	35	38
Telefónica Móviles México, S.A. de C.V.	97	176
Telefónica de Costa Rica, S.A.	74	127
Inversiones Telefónica Fija, S.A.	67	
Telefónica Capital, S.A.U.	76	
Telefónica Digital Holding, S.A.U.	47	
Other companies	11	37
Total	**2,873**	**458**

2012

On September 11 and 13, 2012, the Company completed two capital increases in Telfin Ireland, Ltd. totalling 1,005 million euros. In September 2012, the share capital of Telfisa Global, B.V. was increased by 703 million euros. The aforementioned transactions were performed as part of the Group s reorganization of various subsidiaries in Europe, prior to the initial public offering (IPO) of Telefónica Germany, GmbH.

On November 22, 2012, Telfin Ireland, Ltd increased its capital again by 76 million euros, subscribed by the Company. These funds were then transferred to Telefónica O2 Holding, Ltd. as a loan to enable this subsidiary to meet its general financing requirements.

The amount for Telefónica Chile Holdings, B.V. relates to the capital increase carried out on December 24, 2012 subscribed in full by Telefónica, S.A. as explained in the previous chapter.

On May 31, 2012 the Board of Directors of Telefónica, S.A. ratified the refinancing proposal that Telco, S.p.A. had submitted for approval by its partners. This refinancing involved increasing share capital by 277 million euros and subscribing a bond of 208 million euros, as well as renewing the existing bond of 600 million euros (see Note 8.5).

In April 2012, Telefónica, S.A. subscribed various share capital increases in Telefónica Móviles México, S.A. de C.V. totalling 1,668 million Mexican pesos (97 million euros) in order to provide the subsidiary with the funds needed to pay for the spectrum licenses acquired in 2011.

2011

On June 27, 2011, Telefónica, S.A. performed a capital increase of 1,285 million Mexican pesos (76 million euros) at its subsidiary Telefónica Móviles México, S.A. de C.V. In October 2011, several more capital increases were carried out, totalling 1,832 million Mexican pesos (100 million euros).

In late 2010, the Telefónica Group was awarded a mobile telephone license in Costa Rica. Until that date, the Group had no operations in that country. To operate under this license, on February 14, 2011 Telefónica, S.A. incorporated the company Azules y Platas, S.A., with 2 million US dollars. The Company made an additional contribution to equity of 6 million euros on February 15, 2011, as well as a capital increase of 170 million US dollars on June 26, 2011. The euros value of the three aforementioned capital increases is 127 million euros. On September 22, 2011 the change of name of this company, to Telefónica de Costa Rica, S.A., was formally entered in the pertinent mercantile registry.

On September 26, 2011, Telefónica, S.A. injected a further 80 million euros of equity into Casiopea Re, S.A.

On October 31, 2011, Telefónica, S.A. injected a further 38 million euros of equity in its subsidiary Telefónica Global Technology, S.A.U.

b) Disposals of investments and capital decreases:

Millions of euros Companies	2012	2011
Subsidiaries:		
Telefónica O2 Europe, Ltd.	5,729	
Telefónica de España, S.A.U.	731	
Inversiones Telefónica Móviles Holding, S.A. (Chile)	652	
Telefónica Czech Republic, a.s.	114	
Telefónica Móviles Puerto Rico, Inc.	110	
Telefónica Móviles Argentina Holding, S.A.		285
Atento Inversiones y Teleservicios, S.A.		116
Other companies	85	3
Total Subsidiaries:	**7,421**	**404**

2012

On December 5, Telefónica O2 Europe, Ltd resolved to pay back contributions totaling 5,729 million to its parent. This consideration was collected in December 2012.

On March 27, 2012, it was resolved at the Ordinary General Shareholders Meeting of Telefónica de España, S.A.U. to distribute dividends of 221 million euros and repay contributions of 731 million euros. The dividends are recognized as revenues in the income statement (see Note 19.1.) and the repayment of contributions is recognized under Disposals in the accompanying table of movements. These considerations were collected in 2012.

On November 12, 2012, it was resolved at the Extraordinary Shareholders Meeting of Inversiones Telefónica Móviles Holding, S.A. to reduce share capital by repaying contributions totaling 652 million euros. This consideration was collected in December 2012.

On May 25, 2012, it was resolved at the Ordinary General Shareholders Meeting of Telefónica Czech Republic, a.s. to reduce share capital by 4,187 million Czech crowns. Once the transaction had been approved by the state authorities, it was recognized by Telefónica, S.A. in November 2012, having an impact of 114 million euros, which was repaid by the subsidiary in December 2012.

On July 18, 2012, the State Department of Puerto Rico ratified the winding up of Telefónica Móviles Puerto Rico, Inc. The investment amounted to 110 million euros and was provisioned for in full at the time of its liquidation; therefore this event has not had an impact in the income statement.

2011

In January 2011, Telefónica, S.A. sold a 25% stake in Telefónica Móviles Argentina Holding, S.A. to Telefónica Internacional, S.A.U., at market value as determined in an independent expert report. This sale generated gains of 511 million euros, recognized under Gains (losses) on disposal and other gains and losses in the accompanying income statement (see Note 19.9).

On March 31, 2011, Atento Inversiones y Teleservicios, S.A. resolved to pay out 150 million euros to its sole shareholder, Telefónica, S.A. 116 million euros of that amount related to a reduction in the share premium, recognized as a return of contributions and thus stated as a disposal in the table of movements for the year. The remainder, 34 million euros, was recognized in the income statement as income from dividends.

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

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31, 2012 and 2011.

As a result of these estimations and the effect of the net investment hedge in 2012, an impairment provision of 5,312 million euros was recognized. This amount derives mainly from the following companies: (a) the write-down recognized by Telefónica Europe, plc. (3,682 million euros), less 82 million euros for the effect of the net investment hedge and (b)the write-down of 1,305 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year. The write-down of Telefónica Europe, plc. is a consecuence of the net impact of fluctuations in the sterling exchange rate and changes in the present value of expectations regarding the business of the subsidiary, which operates in several European markets.

In 2011, a write-down of 1,606 million euros was recognized, corresponding to the following opposing effects: (a) the reversal of the impairment loss recorded for Telefónica Europe, plc. (1,279 million euros), less 120 million euros for the effect of the net investment hedge; (b) the write-down of 2,085 million euros in Telefónica Móviles México, S.A. de C.V.; (c) the write-down of 629 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies.

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

8.4. Transactions protected for tax purposes

Transactions carried out in 2012 that are considered protected for tax purposes, as defined in Articles 83 or 94, as applicable, of Chapter VII of Title VIII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law (TRLS in Spanish), are detailed in the following paragraphs. Transactions protected for tax purposes carried out in prior years are disclosed in the annual financial statements for those years.

On May 18, 2012, Telefónica, S.A. as sole stakeholder of Telefónica Gestión de Servicios Compartidos España, S.A.U., decided to partially spin off the integrated facilities and building management business, and its contribution to the newly-incorporated Telefónica Gestión Integral de Edificios y Servicios, S.L.U. On the same day, Telefónica Gestión de Servicios Compartidos España, S.A.U, as sole stakeholder of Telefónica Servicios Integrales de Distribución, S.A.U., also decided to partially spin off the special services and postal services business and its contribution to Telefónica Gestión Integral de Edificios y Servicios, S.L.U.

On June 29, 2012, the Colombian company Telefónica Móviles Colombia, S.A. in which Telefónica, S.A. held a 49.42% interest, was taken over (as executed in a public deed in Colombia) by the Colombian company Colombia Telecomunicaciones, S.A. ESP, in which Telefónica Internacional, S.A.U. held a 52.03% interest at that time. As a result of this merger, Telefónica, S.A. and Telefónica Internacional, S.A.U. held interests of 18.51% and 32.54% in the resulting company. As transferor of the absorbed company, Telefónica, S.A. treats the transaction under the Special Regime by applying the provisions set forth in the second paragraph of Article 43.2 of the Income Tax Regulation. Telefónica, S.A. has recognized the portfolio received for the same amount as the portfolio contributed (272 million euros).

At the July 25, 2012 Extraordinary Shareholders Meetings at which all shareholders were present of Acens Technologies, S.L. and Interdomain, S.L., shareholders approved the takeover of Interdomain, S.L. by Acens Technologies, S. L. For this merger and pursuant to Article 36 of Law 3/2009 regarding structural modifications to corporations, the merger balance sheets were considered to be those closed by the absorbing and absorbed companies at December 31, 2011. According to Section 7 of Article 31 of Law 3/2009 regarding structural modifications to corporations, transactions performed by absorbed companies are treated as having been performed by absorbing companies as from January 1, 2012. Pursuant to Article 93 of the TRLS, disclosures on the accounting obligations laid down in this article are presented in the notes to the financial statements of the absorbing company.

On December 10, 2012, Telefónica Chile Holdings, B.V., with registered offices in Holland, and Telefónica, S.A. agreed to exchange the shares of Inversiones Telefónica Fija Holding, S.A.(Chilean company), wholly owned by Telefónica, S.A., for shares in the Dutch company, giving it a 100% stake. The carrying amount of the Chilean company s shares handed over recognized by Telefónica, S.A. was 67 million euros. The shares of the Dutch company received in exchange were recognized for the same amount.

On December 14, 2012, a deed was signed for the non-monetary contribution of the Dutch company Latin America Cellular Holdings, B.V. (wholly owned by Telefónica S.A.), through which all the shares were contributed to Telefónica Latinoamérica Holding, S.L.; a Spanish company in which Telefónica, S.A. has a 94.59% stake and Telefónica Internacional, S.A.U. a 5.41% stake. The carrying amount of the contributed stake in Telefónica, S.A. was 1,749 million euros, while the portfolio received was recognized for the same amount.

On December 17, 2012, Telefónica Gestión de Servicios Compartidos España, S.A.U. agreed to its partial spin-off through the transfer en bloc of 100% of its interest in Telefónica Gestión Integral de Edificios y Servicios, S.L.U. and Tempotel, Empresa de Trabajo Temporal, S.A.U. under universal succession to Taetel, S.L.U. On the same date, it agreed to receive and acquire en bloc the capital of Telefónica Gestión de Servicios Compartidos España, S.A.U., which was partially spun off.

8.5. The breakdown and maturity of loans to Group companies and associates in 2012 and 2011 are follows:

2012

Millions of euros Company	2013	2014	2015	2016	2017	2018 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	971						971
Telefónica Móviles México, S.A. de C.V.	82	1,367					1,449
Telefónica de Contenidos, S.A.U.	72	1,142	79				1,293
Telefónica de España, S.A.U.	384						384
Lotca, S.L.	43	6	5	6	6	39	105
Telefónica Global Technology, S.A.U.	5	5	1	14	14	139	178
Telco, S.p.A.	19	808					827
Telefónica Emisiones, S.A.U.	268	197	56				521
Telefónica Europe, B.V.	84					18	102
Telefónica Internacional, S.A.U.	1,588						1,588
Other companies	92	33	41			12	178
Total	**3,608**	**3,558**	**182**	**20**	**20**	**208**	**7,596**

2011

Millions of euros Company	2012	2013	2014	2015	2016	2017 and subsequent years	Final balance, current and non-current
Telefónica de España, S.A.U.	1,036						1,036
Telefónica Móviles México, S.A. de C.V.	1,298						1,298
Telefónica de Contenidos, S.A.U.	2	1,142		79			1,223
Telefónica Móviles Argentina, S.A.	8	5					13
Telefónica Global Technology, S.A.U.	5	5	5	1	13	75	104
Telco, S.p.A.	614						614
Telefónica Emisiones, S.A.U.	4	117	42				163
Other companies	423	26	22	27	7	52	557
Total	**3,390**	**1,295**	**69**	**107**	**20**	**127**	**5,008**

The main loans granted to Group companies are described below:

The balance of loans granted to Telefónica de España, S.A.U. in 2012 comprises tax receivables from this subsidiary in connection with the consolidated tax group amounting to 384 million euros.

In 2012, the loan granted to Telefónica de España, S.A.U. on January 4, 1999 resulting from the company s spin-off from Telefónica bearing interest at 6.80% and with an outstanding balance of 692 million euros at December 31, 2011 was repaid.

At December 31, 2012, the debt with Telefónica Móviles México, S.A. de C.V. amounted to 23,393 million Mexican pesos, equivalent to 1,367 million euros in 2012 (1,298 million euros at December 31, 2011) recognized as non-current pursuant to the period of collection expected at the reporting date. The interest receivable at December 31, 2012 amounted to 82 million euros, which forms part of current receivables.

The debt with Telefónica de Contenidos, S.A.U. at December 31, 2012 consisted of:

a) a 1,142 million euro 10-year participative loan granted in 2003, which bears interest based on Telefónica de Contenidos, S.A.U. s business performance. This loan is recognized as non-current pursuant to the period of collection expected at the reporting date. Accrued interest receivable at December 31, 2012 amounted to 70 million euros, which forms part of current receivables.

b) a new 79 million euro participative loan granted in 2005 and maturing in 2015. No interest receivable is outstanding in respect of 2012 or 2011; and

c) tax receivables from this subsidiary amounting to 2 million euros, in connection with the consolidated tax group.

On May 28, 2012, Telco, S.p.A. (Telco) issued 1,750 million euros of bonds with fixed interest of 4% maturing in April 2013. Telefónica, S.A. and the rest of the partners undertook to subscribe in proportion to their interests. For Telefónica, S.A., this amounted to 808 million euros. With the proceeds from the bond issue, Telco repaid the bond issued on February 19, 2010, of 1,300 million euros, of which the portion subscribed by Telefónica, S.A. amounted to 600 million euros. The amount drawn down is recognized as non-current pursuant to the period of collection expected at the reporting date. Accrued interest receivable at December 31, 2012 amounted to 19 million euros, which forms part of current receivables (14 million euros in 2011).

The financing awarded to Móviles España, S.A.U. comprises three loans of 81 million euros, 95 million euros and 462 million euros received in 2012, the main purpose of which is to provide the subsidiary with the funds required to pay for the spectrum capacity acquired. These loans fall due in 2013 and are recognized under current receivables.
The Company also has tax receivables from this subsidiary amounting to 333 million euros, in connection with the consolidated tax group.

The debt with Telefónica Global Technology, S.A. (TGT) at December 31, 2012 consisted of:

a) A credit facility signed on January 19, 2010 for 19 million euros with an outstanding balance at December 31, 2012 of 10 million euros (15 million euros in 2011). This financing has a repayment schedule.

b) A number of long-term financing agreements under participative loans which bear interest based on the company s business performance, with an outstanding balance at December 31, 2012 of 168 million euros (90 million euros in 2011). In 2012, two agreements were signed, for 56 million euros and 22 million euros, which were fully drawn down in the year.

In 2012, the Company continued to buy back bonds issued by Telefónica Emisiones S.A.U. and Telefonica Europe, B.V., reaching a total of 606 million euros in the year (a cumulative amount of 159 million euros in 2011). In addition, there was accrued interest receivable at the end of 2012 of 17 million euros (a cumulative amount of 4 million at the end of 2011).

In December 2012, the shareholders of Telefónica Internacional, S.A.U. agreed in general meeting to distribute a dividend of 1,500 million euros against unrestricted reserves, which had yet to be collected at the end of the reporting period. This amount is recognized under current receivables in the table.

Disposals of current loans to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A. s tax group against debts held by these same subsidiaries totaling 665 million euros (703 million euros in 2011).

Table of Contents

The Company has also extended 814 million euros (665 million euros in 2011) of loans in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17), mainly: 333 million euros to Telefónica Móviles España, S.A.U. (264 million euros in 2011), 384 million euros to Telefónica de España, S.A.U. (366 million euros in 2011) and 88 million euros to Telefónica Internacional, S.A.U. (no balance in 2011). All these amounts fall due in the short term.

Total accrued interest receivable at December 31, 2012 included under Current loans to group companies and associates amounted to 191 million euros (27 million euros in 2011).

8.6. Other financial assets with Group companies and associates

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees maturing in 2013, 2014 and 2015 (see Note 19.3).

Table of Contents

Note 9. Financial investments

9.1. The breakdown of Financial investments at December 31, 2012 and 2011 is as follows:

	2012												
	Assets at fair value							Assets at amortized cost					
					Measurement hierarchy								
Millions of euros	**Available-for-sale financial assets**	**Financial assets held for trading**	**Hedges**	**Subtotal assets at fair value**	**Level 1: quoted prices**	**Level 2: Estimates based on other directly observable market inputs**	**Level 3: Estimates not based on observable market data**	**Loans and receivables**	**Other financial assets**	**Subtotal assets at amortized cost**	**Subtotal liabilities at fair value**	**Total carrying amount**	**Total fair value**
Non-current financial investments	**433**	**2,093**	**1,952**	**4,478**	**433**	**4,045**		**39**	**14**	**53**	**53**	**4,531**	**4,531**
Equity instruments	433			433	433							433	433
Derivatives (Note 16)		2,093	1,952	4,045		4,045						4,045	4,045
Loans to third parties and other financial assets								39	14	53	53	53	53
Current financial investments		**222**	**60**	**282**		**282**		**9**	**99**	**108**	**108**	**390**	**390**
Loans to third parties								9	99	108	108	108	108
Derivatives (Note 16)		222	60	282		282						282	282
Total financial investments	**433**	**2,315**	**2,012**	**4,760**	**433**	**4,327**		**48**	**113**	**161**	**161**	**4,921**	**4,921**

	2011												
	Assets at fair value							Assets at amortized cost					
					Measurement hierarchy								
Millions of euros	**Available-for-sale financial assets**	**Financial assets held for trading**	**Hedges**	**Subtotal assets at fair value**	**Level 1: quoted prices**	**Level 2: Estimates based on other directly observable market inputs**	**Level 3: Estimates not based on observable market data**	**Loans and receivables**	**Other financial assets**	**Subtotal assets at amortized cost**	**Subtotal liabilities at fair value**	**Total carrying amount**	**Total fair value**
Non-current financial investments	**556**	**1,574**	**2,544**	**4,674**	**556**	**4,118**		**37**	**17**	**54**	**54**	**4,728**	**4,728**
Equity instruments	556			556	556							556	556
Derivatives (Note 16)		1,574	2,544	4,118		4,118						4,118	4,118
Loans to third parties and other financial assets								37	17	54	54	54	54
Current financial investments		**159**	**189**	**348**		**348**		**46**		**46**	**46**	**394**	**394**
Loans to third parties								46		46	46	46	46
Derivatives (Note 16)		159	189	348		348						348	348
Total financial investments	**556**	**1,733**	**2,733**	**5,022**	**556**	**4,466**		**83**	**17**	**100**	**100**	**5,122**	**5,122**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

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

9.2 Held-for-trading financial assets and hedges

These two categories include the fair value of outstanding derivate financial instruments at December 31, 2012 and 2011 (see Note 16).

9.3 Available-for-sale financial assets.

This category mainly includes the fair value of investments in listed companies (equity instruments) over which the Company does not have significant control or influence. The movement of items composing this category at December 31, 2012 and 2011 are as follows:

	December 31, 2012					
Millions of euros	**Opening balance**	**Additions**	**Disposals**	**Other movements**	**Fair value adjustments**	**Closing balance**
Banco Bilbao Vizcaya Argentaria, S.A.	327			(11)		316
Portugal Telecom, SGPS, S.A.	193		(76)		(33)	84
Other companies	36	47	(35)		(15)	33
Total	**556**	**47**	**(111)**	**(11)**	**(48)**	**433**

	December 31, 2011					
Millions of euros	**Opening balance**	**Additions**	**Disposals**	**Other movements**	**Fair value adjustments**	**Closing balance**
Banco Bilbao Vizcaya Argentaria, S.A.	418			(11)	(80)	327
Portugal Telecom, SGPS, S.A.			(10)	235	(32)	193
Other companies	55		(1)		(18)	36
Total	**473**		**(11)**	**224**	**(130)**	**556**

In 2010, Telefónica entered into three equity swap contracts for Portugal Telecom, SGPS, S.A. shares with a number of financial institutions, subject to net settlement, which grant Telefónica the equivalent total return of the investment.

In October 2011, the Company reclassified the carrying amount of its stake in this company at that date from Available-for-sale financial assets . Consequently, since October 2011, changes in the market value of these shares have been reflected under equity (32 million euros, net of the tax effect, in 2011). In December 2011, the Company sold 1.9 million shares, reflected under Disposals in the table of movements.

In 2012 21 million shares were sold, fully canceling the equity swap agreements with Credit Suisse and Mediobanca. These transactions are shown under Disposals in the table of movements for 2012. The negative impact on the income statement amounts to 34 million euros, recognized under Gain (loss) on available-for-sale financial assets recognized in the period .

In 2012, regarding Banco Bilbao Vizcaya Argentaria, S.A., the only movement in the table relates to the sale of rights to two scrip dividends that the bank distributed in March and September 2012 and were sold on the market. In 2011, this item also amounted to 11 million euros.

In 2011, Telefónica, S.A. adjusted the cost of its investment in Banco Bilbao Vizcaya Argentaria, S.A. by 80 million euros, in order to bring the cost per share in line with the fair value. This adjustment was taken directly to the income statement, under Gain (loss) on available-for-sale financial assets recognized in the period , with no impact on the statement of recognized income and expenses.

At December 31, 2012 Telefónica, S.A. s investment in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), held since 2000, represents 0.81% of that company s share capital.

Amper, S.A. and Zon Multimedia Serviços de Telecommunicaçoes e Multimedia, SGPS, S.A. were sold off in 2012. These investments were recognized under Other companies in the table of movements for 2011. The 21 million euro loss on these transactions is recognized under Gain (loss) on available-for-sale financial assets recognized in the period .

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2012 and 2011 is as follows:

Millions of euros	**2012**	**2011**
Other non-current financial assets		
Loans to third parties	39	37
Prepayments	1	2
Guarantees given	13	15
Other current financial assets:		
Loans to third parties	9	46
Other financial investments	99	
Total	**161**	**100**

9.4.1 Loans to third parties

Non-current loans to third parties includes the cost of the financial instrument arranged in 2011 to partially cover share-based payment schemes involving Telefónica, S.A. shares (Manager and Senior Executive Options Remuneration Plan Performance & Investment Plan (PIP)) for 37 million euros, which will mature in 2014 (see Note 19.3).

Current loans to third parties in 2011 included, inter alia, the value of the financial instrument arranged in 2010 partly to cover the fourth phase of share-based payment schemes involving Telefónica, S.A. shares owing to its falling due in June 2012 (36 million euros).

9.4.2 Guarantees given.

Non-current loans to third parties primarily includes guarantees received from tenants of buildings owned by Telefónica, S.A., to be returned in a period of over 12 months.

Note 10. Trade and other receivables

The breakdown of Trade and other receivables at December 31, 2012 and 2011 is as follows:

Millions of euros	**2012**	**2011**
Trade receivables	22	24
Trade receivables from Group companies and associates	413	453
Other receivables	19	21
Employee benefits payable	1	2
Tax receivables (Note 17)	610	198
Total	**1,065**	**698**

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

Trade receivables and Trade receivables from Group companies and associates in 2012 and 2011 include balances in foreign currency equivalent to 134 million euros. In December 2012, there were receivables in US dollars equivalent to 105 million euros and Czech crowns equivalent to 29 million euros. In December 2011, there were receivables in US dollars equivalent to 104 million euros and Czech crowns equivalent to 30 million euros.

These balances gave rise to exchange losses in the income statement of approximately 3 million euros in 2012 (8 million euros of exchange gains in 2011).

Note 11. Equity

11.1 Capital and reserves

a) Share capital

At December 31, 2012, Telefónica, S.A. s share capital amounted to 4,551,024,586 euros and consisted of 4,551,024,586 fully paid ordinary shares of a single series, per value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system (Continuous Market), where they form part of the Ibex 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the New York, London, Buenos Aires and Lima Stock Exchanges.

With respect to authorizations given regarding share capital, on May 18, 2011, authorization was given at the Annual Shareholders Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company s needs, to increase the Company s capital, at one or several times, within a maximum period of five years from that date, under the terms of Section 297.1.b) of the Corporate Enterprises Act up to a maximum increase of 2,281,998,242.50 euros, equivalent to half of Telefónica, S.A. s share capital at that date, by issuing and placing new shares, be they ordinary, preference, redeemable, non-voting or of any other type permitted by the Law, with a fixed or variable premium, and, in all cases, in exchange for cash, and expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Section 506 of the Spanish Enterprises Act.

In addition, at the June 2, 2010 Shareholders Meeting, authorization was given for the Board of Directors to issue fixed-income securities and preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, plain or, in the case of debentures and bonds, convertible into shares of the Company and/or exchangeable for shares of any of the Group companies. They may also be preferred shares. The total maximum amount of the securities issued agreed under this authorization is 25,000 million euros or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. As at December 31, 2012, the Board of Directors had exercised these powers, approving three programs to issue corporate promissory notes for 2011, 2012 and 2013.

In addition, on June 2, 2010, shareholders voted to authorize the acquisition by the Board of Directors of Telefónica, S.A. treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders Meeting, within a maximum period of five years from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A. s share capital).

On May 25, 2012, the deed of capital reduction formalizing the implementation by Telefónica, S.A. s Board of Directors of the resolution adopted at the Shareholders Meeting on May 14, 2012, was executed. Capital was reduced through the cancellation of treasury shares previously acquired by Telefónica, S.A. as authorized at the Shareholders Meeting. As a result, 84,209,363 Telefónica, S.A. treasury shares were cancelled and the Company s share capital was reduced by a nominal amount of 84,209,363 euros. Article 5 of the Corporate Bylaws relating to the amount of share capital was amended accordingly to show 4,479,787,122 euros. At the same time, a reserve was recorded for the cancelled shares described in the section on Other reserves of this same Note.

The latest share capital modification by Telefónica, S.A. took place on June 8, 2012 and involved a share capital increase of 71,237,464 euros, during which 71,237,464 ordinary shares with a par value of 1 euro each were issued. This formalized the Board of Directors execution of the resolution passed at the Ordinary General Shareholder s Meeting on May 14, 2012 relating to the share capital increase by means of the issue of new ordinary shares of 1 euro par value each, of the same class and series as those already in circulation, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,551,024,586 euros subsequent to this increase.

Table of Contents

At December 31, 2012 and 2011, Telefónica, S.A. held the following treasury shares:

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 12/12/31	47,847,809	10.57	10.19	488	1.05136%

(1) Millions of euros

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (1)	%
Treasury shares at 11/12/31	84,209,363	15.68	13.39	1,127	1.84508%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2012 and 2011 is as follows:

	Number of shares
Treasury shares at 10/12/31	**55,188,046**
Acquisitions	55,979,952
Disposals	(24,058,446)
Delivery PSP Phase III (Note 19.3)	(2,900,189)
Treasury shares at 11/12/31	**84,209,363**
Acquisitions	126,489,372
Delivery GESP share plan (Note 19.3)	(2,071,606)
Disposals	(76,569,957)
Share redemption	(84,209,363)
Treasury shares at 12/12/31	**47,847,809**

Furthermore, at December 31, 2012 and 2011, one Telefónica, S.A. share is held by Telefónica Móviles Argentina, S.A.

The amount paid to acquire treasury shares in 2012 and 2011 was 1,346 million euros and 822 million euros, respectively.

On May 25, 2012, pursuant to the resolutions adopted in the General Shareholders Meeting of May 14, capital was reduced by redeeming 84,209,363 treasury shares, thereby reducing treasury shares by 1,321 million euros.

Treasury shares sold in 2012 and 2011 amounted to 801 million euros and 445 million euros, respectively. The main treasury share sales transactions during 2012 were as follows:

In November 2012, Telefónica submitted an offer to purchase and cancel the preference shares that it had indirectly issued in 2002 through its subsidiary Telefónica Finance USA, LLC totaling 2,000 million euros. The offer involved acquiring these shares at their par value, subject unconditionally and irrevocably to the simultaneous reinvestment in Telefónica, S.A. shares and the subscription of newly issued plain-vanilla bonds, in the following percentage:

a) 40% of the amount in treasury shares of Telefónica, S.A.

b) 60% of the amount shall be used to subscribe a bond issue with a face value of 600 euros, issued at par, the characteristics of which are described in Note 13.

97% of the holders of the preference shares accepted the offer, and therefore 76,365,929 treasury shares with a carrying amount of 815 million euros (exchange value of 776 million euros) were handed over, which are included under Disposals in 2012.

In addition to these disposals, on July 27, 2012, 2,071,606 shares were delivered to to Group employees when the first phase of the Global Employee Share Plan (the GESP) matured. In December 2012, the second phase of the GESP started, and 116,443 treasury shares were used to meet the demand for shares of employees that had joined this plan (see Note 19.1.c).

On June 30, 2011 and July 4, 2011, following the end of the third phase of the Performance Share Plan (PSP) (see Note 19.3), a total of 2,446,104 treasury shares were added, corresponding to two financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. The gross number of shares linked to the plan amounted to 4,166,304 shares, with a net 2,900,189 shares finally awarded (33 million euros).

Expanding on the existing strategic alliance, on January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited (China Unicom) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica acquired through its subsidiary Telefónica Internacional, S.A.U. 282,063,000 shares of China Unicom from third parties for 358 million euros. In recognition of China Unicom s stake in Telefónica, approval was given at Telefónica s General Shareholders Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

At December 31, 2012, Telefónica held 178 million call options on treasury shares subject to physical settlement (190 million options on treasury shares at December 31, 2011).

The Company also has a derivative on Telefónica shares, to be settled by offset, which has increased from 26 million shares in 2011 to 28 million shares in 2012, and is recognized under Derivatives (financial assets, current) on the balance sheet (in 2011, the fair value of this derivative was negative and therefore it was recognized under Derivatives (financial liabilities, current).

b) Legal reserve

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2012, the Company had duly set aside this reserve.

c) Other reserves

Other reserves includes:

The Revaluation reserve which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2012, an amount of 10 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to Other reserves . In 2011, an amount of 15 million euros was reclassified in this connection. The balance of this reserve at December 31, 2012 and 2011 was 116 million euros and 126 million euros, respectively.

Reserve for cancelled share capital: In accordance with Section 335.c) of the Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. In 2012, a reserve for cancelled share capital amounting to 84 million euros was recorded, the same amount as the capital reduction made in the year. The cumulative amount of the reserve for cancelled share capital at December 31, 2012 and 2011 was 582 million euros and 498 million euros.

Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company sets aside a non-distributable reserve of 1.7 million euros for goodwill amortization. The balance of this reserve at December 31, 2012 was 6.8 million euros. The proposed appropriation of 2012 profit (see Note 3) includes an allocation of 1.7 million euros to this restricted reserve.

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

d) Dividends

Dividends paid in 2012

Approval was given at the General Shareholders Meeting of May 14, 2012 to pay a gross 0.53 euro dividend per share outstanding with a charge to unrestricted reserves. The dividend was paid on May 18, 2012 and the total amount paid was 2,346 million euros.

In addition, approval at the same meeting was given to pay a scrip dividend consisting of the assignment of free allotment rights with an irrevocable purchase obligation on the Company, and a subsequent capital increase by means of the issue of new shares to fulfill said allotments.

At the close of the trading period for these rights, the holders of 37.68% of the Company s shares had accepted the Company s irrevocable commitment to buy. These rights have been repurchased and cancelled by the Company for the amount of 490 million euros.

62.32% of shareholders with allotment rights opted for the right to receive new Telefónica shares. A capital increase was required to fulfill said allotments, by means of the issue of 71,237,464 new shares with a nominal value of one euro each, which have been delivered to the shareholders who held the rights thereto.

Dividends paid in 2011

At its meeting of April 12, 2011, Telefónica, S.A. s Board of Directors resolved to pay an interim dividend against 2011 profit of a fixed gross 0.75 euros per outstanding share carrying dividend rights. This dividend was paid in full on May 6, 2011, and the total amount paid was 3,394 million euros.

In addition, approval was given at the General Shareholders Meeting on May 18, 2011 to pay a gross 0.77 dividend per share outstanding carrying dividend rights with a charge to unrestricted reserves. This dividend was paid in full on November 7, 2011, and the total amount paid was 3,458 million euros.

11.2 Unrealized gains (losses) reserve

The movements in the items composing Unrealized gains (losses) reserve in 2012 and 2011 are as follows:

2012

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	(40)	(46)	14	55	(17)	(34)
Cash flow hedges (Note 16)	(575)	(1,310)	393	173	(52)	(1,371)
Total	**(615)**	**(1,356)**	**407**	**228**	**(69)**	**(1,405)**

2011

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	(5)	(50)	15			(40)
Cash flow hedges (Note 16)	(145)	(824)	247	210	(63)	(575)
Total	**(150)**	**(874)**	**262**	**210**	**(63)**	**(615)**

Note 12. Financial liabilities

The breakdown of Financial liabilities at December 31, 2012 and 2011 is as follows:

	2012									
	LIABILITIES AT FAIR VALUE									
				MEASUREMENT HIERARCHY			LIABILITIES AT AMORTIZED COST			
Millions of euros	**Financial liabilities held for trading**	**Hedges**	**Subtotal financial liabilities at fair value**	**Level 1: quoted prices**	**Level 2: Estimates based on other directly observable market inputs**	**Level 3: Estimates not based on other directly observable market data**	**Trade and other payables**	**Subtotal liabilities at fair value**	**TOTAL CARRYING AMOUNT**	**TOTAL FAIR VALUE**
Non-current financial liabilities	**1,638**	**1,492**	**3,130**		**3,130**		**46,213**	**49,439**	**49,343**	**52,569**
Payable to Group companies and associates							36,069	38,511	36,069	38,511
Bank borrowings							9,232	9,676	9,232	9,676
Bonds and other marketable debt securities							828	1,168	828	1,168
Derivatives (Note 16)	1,638	1,492	3,130		3,130				3,130	3,130
Other financial liabilities							84	84	84	84
Current financial liabilities	**116**	**8**	**124**		**124**		**16,154**	**16,088**	**16,278**	**16,212**
Payable to Group companies and associates							14,181	14,230	14,181	14,230
Bank borrowings							1,145	1,028	1,145	1,028
Bonds and other marketable debt securities							828	830	828	830
Derivatives (Note 16)	116	8	124		124				124	124
Other financial liabilities										
Total financial liabilities	**1,754**	**1,500**	**3,254**		**3,254**		**62,367**	**65,527**	**65,621**	**68,781**

Table of Contents

Millions of euros	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data	Trade and other payables	Subtotal liabilities at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
	2011									
	LIABILITIES AT FAIR VALUE			**MEASUREMENT HIERARCHY**			**LIABILITIES AT AMORTIZED COST**			
Non-current financial liabilities	**1,123**	**910**	**2,033**		**2,033**		**44,687**	**41,038**	**46,720**	**43,071**
Payable to Group companies and associates							35,381	33,465	35,381	33,465
Bank borrowings							9,046	7,374	9,046	7,374
Bonds and other marketable debt securities							170	109	170	109
Derivatives (Note 16)	1,123	910	2,033		2,033				2,033	2,033
Other financial liabilities							90	90	90	90
Current financial liabilities	**183**	**21**	**204**		**204**		**17,969**	**17,078**	**18,173**	**17,282**
Payable to Group companies and associates							17,140	16,270	17,140	16,270
Bank borrowings							742	721	742	721
Bonds and other marketable debt securities							87	87	87	87
Derivatives (Note 16)	183	21	204		204				204	204
Other financial liabilities										
Total financial liabilities	**1,306**	**931**	**2,237**		**2,237**		**62,656**	**58,116**	**64,893**	**60,353**

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

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

Note 13. Bonds and other marketable debt securities

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2012 and 2011 are as follows:

2012

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	**170**	**87**	**257**
Additions	1,165	332	1,497
Depreciation and amortization		(87)	(87)
Revaluation and other movements	(7)	(4)	(11)
Closing balance	**1,328**	**328**	**1,656**
Details of maturities:			
Non-current	828		828
Current	500	328	828

2011

Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	**148**	**104**	**252**
Additions		44	44
Depreciation and amortization		(62)	(62)
Revaluation and other movements	22	1	23
Closing balance	**170**	**87**	**257**
Details of maturities:			
Non-current	170		170
Current		87	87

Maturities of the nominal amounts of debenture and bond issues at December 31, 2012 and 2011 are as follows:

2012

Millions of euros			Maturity							
Name	**Interest rate**	**% interest rate**	**2013 (1)**	**2014**	**2015 (1)**	**2016**	**2017**	**Subsequent years**	**TOTAL**
DEBENTURES AND BONDS:									
JULY 99	ZERO COUPON (**)	6.39%						69	69
MARCH 00	FLOATING	2.411%(*)			50				50
NOVEMBER 12	FIX	4.18%	500		500			164	1,164
Total issues			**500**		**550**			**233**	**1,283**

(*) The applicable interest rate (floating, set annually) is the sterling 10-year swap rate multiplied by 1.0225.
(**) Issues of zero-coupon debentures and bonds are shown in the table above at amortized cost.
(1) For 2013 and 2015 the figures include a maturity of 500 million in both years, without a contractual obligation for these maturities, based on expectations of improvals in financial market conditions.

2011

Millions of euros			Maturity						
Name	**Interest rate**	**% interest rate**	**2012**	**2013**	**2014**	**2015**	**2016**	**Subsequent years**	**TOTAL**
DEBENTURES AND BONDS:									
JULY 99	ZERO COUPON (**)	6.39%						64	64
MARCH 00	FLOATING	3.831% (*)				50			50
Total issues						**50**		**64**	**114**

(*) The applicable interest rate (floating, set annually) is the sterling 10-year swap rate multiplied by 1.0225.
(**) Issues of zero-coupon debentures and bonds are shown in the table above at amortized cost.

13.2. The detail of the maturities and redemption values of zero-coupon debentures and bonds at December 31, 2012 and 2011 is as follows:

Issue	**Redemption date**	**Redemption rate**	**Redemption value**
DEBENTURES AND BONDS:			
JULY 99	2029/21/07	637.639%	191
Total			**191**

The remaining debentures and bonds have been measured at amortized cost at the year end.

Table of Contents

13.3 At December 31, 2012, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

Millions of euros Amount	Placement system	Nominal amount of the Promissory notes	Terms of the Promissory notes	Placement
	Auctions	1,000 euros	1, 2, 3, 6, 12, 18 and 25 months	Competitive auctions at least once a month
500 million; can be increased to 2,000 million	Tailored	100,000 euros	Between 7 and 750 days	Specific transactions

At December 31, 2012 the outstanding balance on this promissory note program was 332 million euros (87 million euros in 2011).

13.4 The average interest rate during 2012 on debentures and bonds outstanding during the year was 4.56% (4.74% in 2011) and the average interest rate on corporate promissory notes was 2.37% (1.88% in 2011).

Note 14. Interest-bearing debt and derivates

14.1 The balances at December 31, 2012 and 2011 are as follows:

December 31, 2012

Millions of euros

Item	Current	Non-current	Total
Loans with financial entities	1,145	9,232	10,377
Derivative financial liabilities (Note 16)	124	3,130	3,254
Total	**1,269**	**12,362**	**13,631**

December 31, 2011

Millions of euros

Item	Current	Non-current	Total
Loans with financial entities	742	9,046	9,788
Derivative financial liabilities (Note 16)	204	2,033	2,237
Total	**946**	**11,079**	**12,025**

14.2 The nominal values of the main interest-bearing debts at December 31, 2012 and 2011 (in million of euros) are as follows:

December 31, 2012

Description	Value date	Maturity date	Currency	Limit 2012/12/31 (millions)	Balance (millions of euros)
Syndicated loan Tranche D2*	12/14/12	12/14/15	EUR	923	923
Bilateral loan	02/27/12	02/27/15	EUR	200	200
ECAS structured facility**	05/03/11	07/30/21	USD	370	135
Syndicated loan Tranche A1	07/28/10	07/28/13	EUR	1,000	1,000
Syndicated loan Tranche A2	07/28/10	07/28/14	EUR	2,000	2,000
Syndicated loan Tranche A3	07/28/10	07/28/16	EUR	2,000	2,000
Syndicated loan Tranche B	07/28/10	07/28/15	EUR	3,000	3,000
ECAS structured facility**	02/12/10	11/30/19	USD	351	266
Syndicated loan**	04/21/06	04/21/17	EUR	700	700

* Limit in Pounds sterling converted to euros at 12/14/2012

** These credit facilities have a repayment schedule

December 31, 2011

Description	Value date	Maturity date	Currency	Limit 2011/12/31 (millions)	Balance (euros)
Syndicated loan Tranche A1	07/28/10	07/28/13	EUR	1,000	1,000
Syndicated loan Tranche A2	07/28/10	07/28/14	EUR	2,000	2,000
Syndicated loan Tranche A3	07/28/10	07/28/16	EUR	2,000	2,000
Syndicated loan Tranche B	07/28/10	07/28/15	EUR	3,000	3,000
ECAS/EKN loan*	02/12/10	11/30/19	USD	472	259
Syndicated loan savings banks*	04/21/06	04/21/17	EUR	700	700

* These credit facilities have a repayment schedule

14.3 Maturities of balances at December 31, 2012 and 2011 are as follows:

December 31, 2012

Millions of euros

Items	2013	2014	2015	2016	2017	Subsequent years	Closing balance
	Maturity						
Loans with financial entities	1,145	2,097	4,518	2,056	408	153	10,377
Derivative financial liabilities (Note 16)	124	171	342	246	371	2,000	3,254
Total	**1,269**	**2,268**	**4,860**	**2,302**	**779**	**2,153**	**13,631**

December 31, 2011							
Millions of euros	Maturity						
Items	2012	2013	2014	2015	2016	Subsequent years	Closing balance
Loans with financial entities	742	930	1,836	2,989	2,245	1,046	9,788
Derivative financial liabilities (Note 16)	204	61	106	287	192	1,387	2,237
Total	**946**	**991**	**1,942**	**3,276**	**2,437**	**2,433**	**12,025**

14.4 On March 2, 2012, a deal was signed to refinance the two tranches maturing on December 14, 2012 (Tranche D) and December 13, 2013 (Tranche E) of the syndicated loan with Telefónica Europe, B.V., totaling up to 18,500 million pounds sterling entered into on October 31, 2005. As a result of the refinancing deal in 2012, Telefónica S.A. signed a syndicated loan of 729 million pounds sterling (Tranche D2) available from December 14, 2012 and maturing on December 14, 2015. This loan was converted to euros on December 14, 2012, and had an outstanding balance of 923 million euros at December 31, 2012.

On February 27, 2012, Telefónica, S.A. signed a bilateral loan agreement totaling 200 million euros and maturing on February 27, 2015. At December 31, 2012 this loan was drawn down in full.

On June 28, 2010, Telefónica, S.A. obtained a syndicated line of credit with a group of national and international banks for up to a maximum of 8,000 million euros. The line of credit has two tranches: the first for up to 5,000 million euros and a term of three years and the second, for up to 3,000 million euros, which is structured as a revolving credit facility with a five-year term. On May 12, 2011 Telefónica, S.A. signed an amendment whereby it was agreed that of the 5,000 million euros that would initially mature in July 2013, 2,000 million euros would be extended for another year, i.e. until July 2014, and another 2,000 million for a further three years, i.e. until July 2016. At December 31, 2012 the outstanding balance drawn down on this line of credit amounted to 8,000 million euros (8,000 million euros at December 31, 2011).

On May 3, 2011, Telefónica, S.A. arranged long-term financing for an amount of 376 million US dollars at fixed rates guaranteed by the export credit agencies of Finland (Finnvera). This line of credit is structured into four tranches: a tranche of 94 million US dollars maturing on January 30, 2020, another of 90 million US dollars maturing on July 30, 2020, a third of 94 million US dollars maturing on January 30, 2021, and a fourth of 98 million US dollars maturing on July 30, 2021. During 2012, 184 million US dollars of the first and second tranches were paid, although as this financing has a repayment schedule, 6 million US dollars of the first tranche was repaid in 2012. At December 31, 2012, the outstanding principal amount of this credit facility was 178 million US dollars (equivalent to 135 million euros).

On February 12, 2010, Telefónica, S.A. signed a long-term line of credit of 472 million US dollars at a fixed rate and guaranteed by the Swedish Export Credits Guarantee Board (EKN). This credit facility is divided into three tranches: a tranche of 232 million US dollars maturing on November 30, 2018, another of 164 million US dollars maturing on April 30, 2019, and a third of 76 million US dollars maturing on November 30, 2019. During the year, it repaid 71 million US dollars of the third tranche, although since this facility has a repayment schedule, during 2012 55 million US dollars were repaid of the first and second tranche. The outstanding balance on this line of credit amounted to 351 million US dollars (equivalent to 266 million euros) at December 31, 2012 (335 million dollars at December 31, 2011).

On April 21, 2006, Telefónica S.A. arranged a 700 million euros syndicated loan, denominated in euros and bearing interest linked to Euribor. In 2012 and 2011, there were no movements in this loan, which will be repaid in two equal installments, in April 2015 and 2017, respectively.

In addition, Telefónica signed three equity swap contracts with different financial entities in June 2010. These swaps are based on the share price of Portugal Telecom and are settled net, thereby obtaining the same economic returns. The amount received from these contracts is recognized as current interest-bearing debt. During 2012, two of these contracts was fully cancelled, and third partially cancelled by reducing the nominal value of these swaps by 21 million shares in total, whereby the outstanding balance is 22 million euros.

14.5 Average interest on loans and borrowings

The average interest rate in 2012 on loans and borrowings denominated in euros was 2.918% and on foreign-currency loans and receivables it was 2.341%.

The average interest rate in 2011 on loans and borrowings denominated in euros was 2.376% and on foreign-currency loans and receivables it was 3.354%.

14.6 Unused credit facilities

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

At December 31, 2012 and 2011, Telefónica had undrawn credit facilities amounting to 5,255 million euros and 6,764 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2012 and 2011 is not subject to compliance with any financial covenants.

Note 15. Payable to group companies and associates

15.1 The breakdown at December 31, 2012 and 2011 is as follows:

December 31, 2012			
Millions of euros	**Non-current**	**Current**	**Total**
Loans	35,757	13,779	49,536
Trade payables to Group companies and associates	56	132	188
Derivatives (Note 16)		20	20
Payable to subsidiaries due to taxation on a consolidated basis	256	250	506
Total	**36,069**	**14,181**	**50,250**

December 31, 2011			
Millions of euros	**Non-current**	**Current**	**Total**
Loans	34,855	16,993	51,848
Trade payables to Group companies and associates		129	129
Derivatives (Note 16)		14	14
Payable to subsidiaries due to taxation on a consolidated basis	526	4	530
Total	**35,381**	**17,140**	**52,521**

Table of Contents

The maturity of these loans at the 2012 and 2011 year ends is as follows:

December 31, 2012

Company (Millions of euros)	2013	2014	2015	2016	2017	2018 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	4,263	4,357	3,458	6,296	4,036	14,267	36,677
Telefónica Europe, B.V.	2,470		795		156	1,842	5,263
Telfisa Global, B.V.	1,822						1,822
Telefónica Finanzas, S.A.U.	5,224		475	75			5,774
Total	13,779	4,357	4,728	6,371	4,192	16,109	49,536

December 31, 2011

Company (Millions of euros)	2012	2013	2014	2015	2016	2017 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	1,343	3,445	4,370	3,504	6,315	13,101	32,078
Telefónica Europe, B.V.	6,478	1,957	14			1,599	10,048
Telfisa Global, B.V.	2,332						2,332
Telefónica Finanzas, S.A.U.	6,830			476	74		7,380
Others	10						10
Total	16,993	5,402	4,384	3,980	6,389	14,700	51,848

The carrying amount of financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2012 was 5,263 million euros (10,048 million euros at the 2011 year end). This financing entails a number of loans paying market rates of interest calculated on a Euribor plus spread basis, with an average interest rate in 2012 of 3.52% (3.52% in 2011), bonds amounting to 2,947 million euros (3,266 million euros in 2011) and commercial paper amounting to 768 million euros (1,596 million euros in 2011).

The main source of this financing was the funds obtained through the following transactions:

1. On March 2, 2012, a deal was signed to refinance the two tranches maturing on December 14, 2012 (Tranche D) and December 13, 2013 (Tranche E) of the syndicated loan with Telefónica Europe, BV., totaling up to 18,500 million pounds sterling entered into on October 31, 2005. As a result, Telefónica Europe, BV entered into: a) a syndicated loan contract for 633 million pounds sterling (tranche D1), available as from December 14, 2012 and maturing on December 14, 2015 (this loan was converted to euros on December 14, 2012 and had an outstanding balance of 801 million euros at year-end 2012); (b) a 756 million euros syndicated loan (tranche E1) available as from March 2, 2012, maturing on March 2, 2017, on which no amounts had been drawn down at 2012 year end; and (c) a syndicated loan of 1,469 million pounds sterling (tranche E2), available as from December 13, 2013 and maturing on March 2, 2017.

2. On January 5, 2012, Telefónica Europe, B.V. signed a financing agreement with China Development Bank (CDB) amounting to 375 million US dollars (approximately 284 million euros) maturing in 2022, which had been fully drawn down at 2012. This financing has a repayment schedule of fifteen six-monthly installments payable as from April 15, 2015.

3. The syndicated multicurrency loan arranged between Telefónica Europe, B.V. and a group of financial institutions for an amount of up to 18,500 million pounds sterling on October 31, 2005 to fund the acquisition of O2, Plc. The outstanding balance on this loan at December 31, 2012 is 100 million pounds sterling, equivalent to 123 million euros (2,965 million euros at December 31, 2011).

4. On October 31, 2012, the Group launched an offer to acquire preferred stock of Telefónica Finance USA, LLC. (see Note 11). As a result of this offer, on November 29, 2012, the Company purchased 1,941,235 preference shares, whereby the balance outstanding at December 31, 2012 amounted to 59 million euros (2,000 million euros at December 31, 2011).

The carrying amount of financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2012 was 36,677 million euros (32,078 million euros in 2011). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2012 was 5.16% (5.06% in 2011). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2012 mainly by tapping the European and US capital markets, issuing the following bonds totaling 5,148 million euros (4,495 million euros in 2011):

Description	Issue date	Maturity date	Amount (nominal)	Issue currency	Coupon
EMTN bonds	2012/02/07	2017/02/07	120,000,000	EUR	4.750%
	2012/02/21	2018/02/21	1,500,000,000	EUR	4.797%
	2012/03/12	2020/03/12	700,000,000	GBP	5.597%
	2012/03/30	2017/03/30	1,250,000,000	CZK	3.934%
	2012/07/11	2018/07/11	10,000,000,000	JPY	4.250%
	2012/09/19	2017/09/05	1,000,000,000	EUR	5.811%
	2012/10/19	2020/01/20	1,200,000,000	EUR	4.710%
	2012/12/14	2018/12/14	250,000,000	CHF	2.718%
	2012/12/14	2022/12/14	150,000,000	CHF	3.450%

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes restatements to amortized cost at December 31, 2012 and 2011 as a result of fair value interest rate and exchange rate hedges.

Meanwhile, at December 31, 2012, Telefónica, S.A. had raised financing from Telefónica Finanzas, S.A.U., in charge of the integrated cash management of the companies comprising the Telefónica Group in Spain, amounting to 5,774 million euros (7,380 million euros at December 31, 2011) in a series of loans bearing interest at market rates.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States and Europe. The balance payable to this subsidiary is formalized through several Deposit Agreements accruing interest at market rates and amounting to 1,822 million euros in 2012 and 2,332 million euros in 2011.

Loans to Group companies under current assets include accrued interest receivable at December 31, 2012 of 878 million euros (829 million euros in 2011).

15.2 The balance of Payable to subsidiaries due to taxation on a consolidated basis was 506 million euros and 530 million euros at December 31, 2012 and 2011, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax losses) to the tax group headed by Telefónica, S.A. (see Note 17). The current- or non-current classification is based on the Company s projection of maturities.

The main amounts are those relating to Telefónica Internacional, S.A.U. for 322 million euros (283 million euros in 2011), Telefónica Móviles España, S.A.U. for 123 million euros (130 million euros in 2011) and Telefónica de España, S.A.U. (no balance in 2012 and 32 million euros in 2011).

Note 16. Derivate financial instruments and risk management policies

a) Derivative financial instruments

During 2012, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2012, the total outstanding balance of derivatives transactions was 121,514 million euros (141,155 million euros in 2011), of which 96,532 million euros related to interest rate risk and 24,982 million euros to foreign currency risk. In 2011, 119,772 million euros related to interest rate risk and 21,383 million euros to foreign currency risk.

It should be noted that at December 31, 2012, Telefónica, S.A. had transactions with financial institutions to hedge exchange rate risk for other Telefónica Group companies amounting to 507 million euros (696 million euros in 2011). At year-end 2012 and 2011, the Company had no transactions to hedge interest rate risk for other Group companies. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

The breakdown of Telefónica, S.A. s interest rate and exchange rate derivatives at December 31, 2012, their notional amounts at year end and the expected maturity schedule is as follows:

Millions of euros	**2012**	**Telefonica receives**		**Telefonica pays**	
Type of risk	**Value in Euros**	**Carrying**	**Currency**	**Carrying**	**Currency**
Euro interest rate swaps	**72,164**				
Fixed to fixed	55	55	EUR	55	EUR
Fixed to floating	24,380	24,380	EUR	24,380	EUR
Floating to fixed	47,679	47,679	EUR	47,679	EUR
Floating to floating	50	50	EUR	50	EUR
Foreign currency interest rate swaps	**22,157**				
Fixed to floating					
CHFCHF	331	400	CHF	400	CHF
CZKCZK	50	1,250	CZK	1,250	CZK
GBPGBP	3,498	2,855	GBP	2,855	GBP
JPYJPY	150	17,000	JPY	17,000	JPY
USDUSD	14,364	18,951	USD	18,951	USD
Floating to fixed					
CZKCZK	50	1,250	CZK	1,250	CZK
GBPGBP	1,445	1,180	GBP	1,180	GBP
USDUSD	2,269	2,994	USD	2,994	USD
Exchange rate swaps	**13,719**				
Fixed to fixed					

EURBRL	203	222	EUR	546	BRL
EURCLP	60	50	EUR	37,800	CLP
EURCZK	622	631	EUR	15,641	CZK
Fixed to floating					
USDEUR	95	132	USD	95	EUR
Floating to floating					
CHFEUR	332	400	CHF	332	EUR

EURCZK	327	322	EUR	8,228	CZK
EURGBP	496	588	EUR	405	GBP
GBPEUR	829	700	GBP	829	EUR
JPYEUR	167	17,000	JPY	167	EUR
USDEUR	10,588	14,196	USD	10,588	EUR
Forwards	**7,399**				
ARSUSD	14	110	ARS	19	USD
CLPEUR	64	40,428	CLP	64	EUR
CZKEUR	115	2,906	CZK	115	EUR
EURBRL	18	18	EUR	49	BRL
EURCOP	1	1	EUR	3,100	COP
EURCZK	541	550	EUR	13,612	CZK
EURGBP	1,345	1,356	EUR	1,098	GBP
EURPEN			EUR	1	PEN
EURMXN	80	81	EUR	1,361	MXN
EURUSD	2,092	2,137	EUR	2,760	USD
GBPEUR	1,904	1,539	GBP	1,904	EUR
GBPUSD	45	36	GBP	59	USD
USDARS	17	19	USD	110	ARS
USDBRL	27	34	USD	71	BRL
USDCLP	5	6	USD	2,964	CLP
USDCOP	1	2	USD	2,796	COP
USDEUR	1,101	1,443	USD	1,101	EUR
USDGBP	28	37	USD	23	GBP
USDPEN	1	1	USD	2	PEN
Spot	**111**				
CZKEUR	106	2,672	CZK	106	EUR
EURGBP	5	5	EUR	3	GBP
Subtotal	**115,550**				

Millions of euros

Notional amounts of structured products with options	Value in euros	Notional	Currency
Interest rate options Caps & Floors	**2,211**		
Caps & Floors	**2,211**		
USD	42	54	USD
EUR	1,250	1,250	EUR
GBP	919	750	GBP
Currency options	**3,753**		
GBPEUR	640	522	GBP
USDEUR	3,113	4,108	USD
Subtotal	**5,964**		
TOTAL	**121,514**		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	**540**		**280**	**60**	**200**
Loans	**18,005**	**2,592**	**3,555**	**1,480**	**10,378**
in national currency	13,170	1,900	2,750	850	7,670
in foreign currencies	4,835	692	805	630	2,708
Debentures and bonds MtM	**73,604**	**11,474**	**12,171**	**21,736**	**28,223**
in national currency	29,475	6,315	6,701	7,839	8,620
in foreign currencies	44,129	5,159	5,470	13,897	19,603
Other underlying*	**29,365**	**16,617**	**4,472**	**5,054**	**3,222**
Swaps	1,212	164	457	591	
Currency options	3,754	2,035	161	1,438	120
Forward	7,772	7,772			
IRS	16,627	6,646	3,854	3,025	3,102
Total	121,514	30,683	20,478	28,330	42,023

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.

The breakdown of Telefónica, S.A. s derivatives in 2011, their notional amounts at year end and the expected maturity schedule is as follows:

Millions of euros	**2011**	**Telefonica receives**		**Telefonica pays**	
Type of risk	**Value in Euros**	**Carrying**	**Currency**	**Carrying**	**Currency**
Euro interest rate swaps	**92,082**				
Fixed to fixed	2,078	2,078	EUR	2,078	EUR
Fixed to floating	21,812	21,812	EUR	21,812	EUR
Floating to fixed	63,977	63,977	EUR	63,977	EUR
Floating to floating	4,215	4,215	EUR	4,215	EUR
Foreign currency interest rate swaps	**19,971**				
Fixed to floating					
GBP/GBP	2,412	2,015	GBP	2,015	GBP
JPY/JPY	220	22,000	JPY	22,000	JPY
USD/USD	14,385	18,612	USD	18,612	USD
Floating to fixed					
GBP/GBP	909	760	GBP	760	GBP
USD/USD	2,045	2.446	USD	2.446	USD
Exchange rate swaps	**12,422**				
Fixed to fixed					
EUR/BRL	331	318	EUR	804	BRL
EUR/CLP	131	112	EUR	87,800	CLP
EUR/CZK	606	631	EUR	15,641	CZK
Fixed to floating					
MAD/EUR	88	1,000	MAD	88	EUR
JPY/EUR	95	15,000	JPY	95	EUR
Floating to fixed					
EUR/MAD	90	90	EUR	1,000	MAD
Floating to floating					
EUR/CZK	319	322	EUR	8,228	CZK
EUR/GBP	484	588	EUR	405	GBP
JPY/EUR	244	37,000	JPY	244	EUR
USD/EUR	10,034	13,482	USD	10,034	EUR
Forwards	**6,820**				
ARS/USD		2	ARS	1	USD
CLP/EUR	147	101,490	CLP	147	EUR
CZK/EUR	5	125	CZK	5	EUR
EUR/BRL	18	17	EUR	44	BRL
EUR/CZK	556	567	EUR	14,335	CZK
EUR/GBP	941	933	EUR	786	GBP
EUR/MXN	2	2	EUR	35	MXN
EUR/USD	1,690	1,625	EUR	2,186	USD
GBP/EUR	2,447	2,094	GBP	2,447	EUR

GBP/USD	17	14	GBP	22	USD
USD/ARS	1	1	USD	6	ARS
USD/BRL	168	224	USD	408	BRL
USD/CLP	11	14	USD	7,183	CLP
USD/COP	1	1	USD	2,756	COP
USD/EUR	763	1,014	USD	763	EUR
USD/GBP	53	69	USD	44	GBP
USD/PEN			USD	1	PEN
Spot	**1**				
MXN/EUR	1	17	MXN	1	EUR
USD/EUR			USD		EUR
Subtotal	**131,296**				

Millions of euros

Notional amounts of structured products with options	Value in Euros	Notional	Currency
Interest rate options Caps & Floors	**7,719**		
Swaptions	850	850	EUR
Caps&Floors	**6,869**		
USD	54	69	USD
EUR	4,900	4,900	EUR
GBP	1,915	2,293	GBP
Currency options	**2,140**		
USD/EUR	2,140	2,725	USD
Subtotal	**9,859**		
TOTAL	**141,155**		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	**536**	**56**	**280**		**200**
Loans	**37,993**	**22,567**	**1,794**	**3,430**	**10,202**
in national currency	33,911	21,447	1,400	2,950	8,114
in foreign currencies	4,082	1,120	394	480	2,088
Debentures and bonds MtM	**80,299**	**16,439**	**13,181**	**23,220**	**27,459**
in national currency	34,446	7,014	7,951	9,145	10,336
in foreign currencies	45,853	9,425	5,230	14,075	17,123
Without underlying*	**22,327**	**8,979**	**5,343**	**2,499**	**5,506**
Swaps	10,767	1,045	4,871	1,999	2,852
Spots	850	850			
Currency options	2,140	283	138	160	1,559
Forward	6,820	6,801	19		
IRS	1,750		315	340	1,095
Total	**141,155**	**48,041**	**20,598**	**29,149**	**43,367**

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.
The debentures and bonds hedged relate to both those issued by Telefónica, S.A. and intragroup loans on the same terms as the issues of Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

The fair value of Telefónica, S.A. s derivatives portfolio with external counterparties at December 31, 2012 was equivalent to a net asset of 1,073 million euros (net asset of 2,229 million euros in 2011).

b) Risk management policy

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

The main market risks affecting Telefónica are as follows:

Exchange rate risk

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

Interest rate risk

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

Share price risk

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

Other risks

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

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

Risk management

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

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

Exchange rate risk

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies and/or synthetic debt in such currencies. The degree of exchange rate hedging employed varies depending on the type of investment.

Telefónica aims to protect itself against declines in Latin American currencies relative to the euro affecting our asset values through, so it occasionally takes out dollar-denominated debt, incurred either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent.

At December 31, 2012, pound sterling-denominated net debt was approximately 1.9 times the value of our 2012 operating income before depreciation and amortization (OIBDA) from the Telefónica Europe business unit in the United Kingdom. Telefónica s aim is to maintain a similar proportion of pound sterling-denominated net debt to OIBDA as the Telefónica net debt to OIBDA ratio, on a consolidated basis, in order to help them to reduce its sensitivity to changes in the pound sterling to euro exchange rate.

The risk-management objective to protect the investment in the Czech Republic is similar to that described for the investment in the UK, where the amount of Czech crown-denominated debt is proportional to the operating income before depreciation and amortization (OIBDA) of the Telefónica Europe business unit in the Czech Republic. Czech crown-denominated net debt at December 31, 2012 was 2.1 times OIBDA in Czech crown (1.7 times in 2011) on a consolidated basis and 2.97 times (2.55 times in 2011) on a proportional basis.

Exchange rate risk is managed by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether there are open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

As Telefónica s direct exposure is counterbalanced by the positions held in subsidiaries, the Company analyses its foreign currency risk exposure at the Group level. To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2012 were constant during 2013 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that consolidated exchange losses recorded for 2013 would be a negative 113 million euros. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to a decrease in finance costs of 45 million euros. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

Interest rate risk

The Telefónica Group s financial expenses are exposed to changes in interest rates. In 2012, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the dollar Libor and the Colombian UVR. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest rate options.

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

To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2012 has been assumed, as well as a 100 basis point decrease in all currencies (EUR, GBP, USD, etc.) in order to avoid negative rates. The constant position equivalent to that prevailing at the end of 2011 has also been assumed.

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2012 was assumed, as well as a 100 basis point decrease in all currencies and terms (except those below 1% in order to avoid negative rates). Cash flow hedge positions were also considered as they are the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

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

	Impact on consolidated result (*)	Impact on Telefónica, S.A.income statement (*)	Impact on consolidated equity	Impact on Telefónica, S.A. equity
+100bp	(96)	(41)	747	747
-100bp	36	20	(685)	(685)

(*) Impact on results of 100 bp change in all currencies, except the pound sterling and the dollar.

Share price risk

The Telefónica Group is exposed to changes in the value of equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

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

To reduce the risk associated with variations in share price under these plans, Telefónica has acquired instruments that replicate the risk profile of some of these plans as explained in Note 19.

The second Global Employee Share Plan was launched as approved in the 2011 Ordinary General Shareholders Meeting (see details of the plan in Note 19).

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at year end to cover shares deliverable under the PSP or the Global Employee Share Plan. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A. s share price.

Liquidity risk

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

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

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

Country risk

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

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

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

Credit risk

As a general rule, the Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. generally trades with credit entities whose senior debt ratings are of at least A . In Spain, where most of the Group s derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. In addition, since Lehman went bankrupt, the credit ratings of rating agencies have proved to be less effective as a credit risk management tool. Therefore, the 5-year CDS (Credit Default Swap) of credit institutions has been added. This way, the CDS of all the counterparties with which Telefónica S.A. operates is monitored at all times in order to assess the maximum allowable CDS for operating at any given time. Transactions are generally only carried out with counterparties whose CDS is below the threshold.

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

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually. Counterparties are chosen according to criteria of liquidity, solvency and diversification based on the conditions of the market and countries where the Group operates. The general framework sets: (i) the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); (ii) the maximum tenor of the investment, set at 180 days; and (iii) the instruments in which the surpluses may be invested (money-market instruments).

The Telefónica Group considers managing commercial credit risk as crucial to meeting its sustainable business and customer base growth targets in a manner that is consistent with its risk-management policy.

This is based on continuous monitoring of the risk assumed and the resources necessary to optimize the risk-reward ratio in its operations. Particular attention is given to those clients and/or products with a financial component that could cause a material impact on the Group s financial statements for which, depending on the segment and type of relation, hedging instruments or instruments that transfer risk may be required to mitigate exposure to credit risk.

All Group companies adopt policies, procedures, authorization guidelines, and homogeneous management practices, in consideration of the particularities of each market and best international practices, and incorporating this commercial credit risk management model into the Group s decision making processes, both from a strategic and day to day operating perspective, which risk assessment guides the commercial offering available for the various credit profiles.

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

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2012, these guarantees amounted to approximately 276 million euros.

Capital management

Telefónica s corporate finance department, which is in charge of Telefónica s capital management, takes into consideration several factors when determining Telefónica s capital structure, with the aim of ensuring sustainability of the business and maximizing the value to shareholders.

Table of Contents

Telefónica monitors its cost of capital with a goal of optimizing its capital structure. In order to do this, Telefónica monitors the financial markets and updates to standard industry approaches for calculating weighted average cost of capital, or WACC. Telefónica also uses a net financial debt ratio below 2.35x OIBDA in the medium term (excluding items of a non-recurring or exceptional nature), enabling to obtain and maintain the desired credit rating over the medium term, and with which the Telefónica Group can match the potential cash flow generation with the alternative uses that could arise at all times.

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

Telefónica s derivatives policy emphasizes the following points:

- Derivatives based on a clearly identified underlying.
- Matching of the underlying to one side of the derivative.
- Matching the company contracting the derivative and the company that owns the underlying.
- Ability to measure the derivative s fair value using the valuation systems available to the Telefónica Group.
- Sale of options only when there is an underlying exposure.

Hedge accounting

Hedges can be of three types:

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

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

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

In 2012 the Company recognized a loss of 0.25 million euros for the ineffective part of cash flow hedges (0.3 million euros in 2011).

Table of Contents

The breakdown of the Company s derivatives with counterparties not belonging to the Telefónica Group at December 31, 2012 and 2011 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

2012						
Millions of euros		**Notional amount maturities (*)**				
Derivatives		**2013**	**2014**	**2015**	**Subsequent years**	**Total**
Interest rate hedges	**341**	**(932)**	**(836)**	**2,555**	**3,601**	**4,388**
Cash flow hedges	1,389	(936)	(350)	2,550	7,730	8,994
Fair value hedges	(1,048)	4	(486)	5	(4,129)	(4,606)
Exchange rate hedges	**(487)**	**1,456**	**(153)**	**1,564**	**6,364**	**9,231**
Cash flow hedges	(487)	1,456	(153)	1,564	6,364	9,231
Fair value hedges						
Interest and exchange rate hedges	**(251)**	**(69)**	**72**	**72**	**2,437**	**2,512**
Cash flow hedges	(251)	(69)	72	72	2,437	2,512
Fair value hedges						
Hedge of net investment	**(115)**	**(822)**	**(230)**	**(162)**	**(989)**	**(2,203)**
Derivatives not designated as hedges	**(561)**	**10,588**	**(63)**	**(467)**	**(1,628)**	**8,430**
Interest rate	(389)	8,612	(13)	(545)	(2,133)	5,921
Exchange rate	(172)	1,976	(50)	78	505	2,509
Interest and exchange rate						

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

2011						
Millions of euros		**Notional amount maturities (*)**				
Derivatives		**2012**	**2013**	**2014**	**Subsequent years**	**Total**
Interest rate hedges	**(58)**	**(1,536)**	**793**	**(824)**	**8,232**	**6,665**
Cash flow hedges	880	(1,040)	1,189	(350)	10,992	10,791
Fair value hedges	(938)	(496)	(396)	(474)	(2,760)	(4,126)
Exchange rate hedges	**(947)**	**194**	**239**		**6,482**	**6,915**
Cash flow hedges	(947)	194	239		6,482	6,915
Fair value hedges						

Interest and exchange rate hedges	**(656)**	**(44)**	**1,154**	**72**	**2,099**	**3,281**
Cash flow hedges	(656)	(44)	1,154	72	2,099	3,281
Fair value hedges						
Hedge of net investment	**(141)**	**(444)**	**(160)**	**(230)**	**(1,254)**	**(2,088)**
Derivatives not designated as hedges	**(427)**	**8,209**	**(441)**	**(194)**	**(1,576)**	**5,998**
Interest rate	(234)	7,855	(579)	(144)	(2,404)	4,728
Exchange rate	(208)	445	138	(50)	828	1,361
Interest and exchange rate	15	(91)				(91)

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

Note 17. Income tax

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2012 comprised 52 companies. Included during the year were Sonora Music Streaming España S.L., Iberbanda, S.A., Acens Tecnologies, S.L, Pléyade Peninsular Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A., Telefónica Digital Venture Capital, S.L., Telefónica Gestión Integral de Edificios y Servicios S.L., Telefónica Latinoamérica Holding S.L., and Telefónica América, S.A. The majority of the Atento group companies ceased forming part of the consolidated tax group in December 2012: Atento Impulsa, S.A., Atento Servicios Técnicos y Consultoría, S.L. and Atento Teleservicios España, S.A. Interdomain, S.A. has been taken over by Acens Technologies, S.L.

Tax balances are as follows:

Millions of euros	2012	2011
Tax receivables:	**5,705**	**2,803**
Deferred tax assets:	**5,095**	**2,605**
Deferred income tax (income)	128	124
Other temporary differences, assets	3,506	1,641
Long-term tax loss carryforwards	1,170	723
Deductions	291	117
Current tax receivables (Note 10):	**610**	**198**
Withholdings	1	52
Corporate income tax payable	584	120
VAT and Canary Islands general indirect tax refundable	25	26
Tax payable:	**618**	**521**
Deferred tax liabilities:	**499**	**474**
Deferred income tax (expense)	9	164
Other temporary differences, liabilities	490	310
Current payables to public administrations (Note 18):	**119**	**47**
Personnel income tax withholdings	3	4
Corporate income tax payable	89	14
Withholding on investment income, VAT and other	26	28
Social security	1	1

The tax group had unused tax loss carryforwards at December 31, 2012 amounting to 11,504 million euros. These losses must be applied within 18 years, according to the following estimated schedule.

2012/12/31	Total	Less than 1 year	More than 1 year
Tax loss carryforwards	**11,504**	263	11,241

Following completion in 2012 of the inspection by the tax authorities (see Note 17.3), and considering the rulings on the tax assessments signed in disagreement by the Company, the Company restated its tax credits based on the business plans of the companies in the tax group and the best estimate of taxable income, over a period of time that is in line with the situation. Consequently, it has recognized tax credits of 458 million euros at year-end 2012.

Total tax credits based on the taxable income recognized in the balance sheet at December 2012 therefore amount to 1,170 million euros (723 million euros in 2011).

Unused tax loss carryforwards in 2011 (amounting to 4,575 million euros) related mainly to a negative adjustment made to the taxable base for corporate income tax at Telefónica Móviles, S.A. (now Telefónica, S.A.) in 2002, amounting to 2,137 million euros and resulting from the transfer of certain holdings where the market value differed from the carrying amount at which they were recognized. Finally, a final ruling was passed, as well as a favorable ruling on the tax credit generated in 2004 on the tax loss on the sale of Lycos, Inc.

During 2012, Telefónica, S.A., as head of the Telefónica tax group, made payments on account of 2012 income tax amounting to 247 million euros. No payments on account were made in 2011, primarily because of exercising the right to decide when to depreciate assets for tax purposes.

17.1 Movement in deferred tax assets and liabilities

The balances and movements in Deferred tax assets and Deferred tax liabilities for Telefónica, S.A. at December 31, 2012 and 2011 are as follows:

2012 Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	**723**	**1,765**	**117**	**2,605**	**474**
Arising in the year	458	1,936	2	2,396	166
Reversal	(11)	(34)		(45)	(156)
Transfers to the tax group s net position		(33)	172	139	
Other movements					15
Closing balance	**1,170**	**3,634**	**291**	**5,095**	**499**

2011 Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	**443**	**1,709**	**65**	**2,217**	**778**
Arising in the year	756	446	11	1,213	280
Reversal		(358)		(358)	(604)
Transfers to the tax group s net position	(476)	(32)	41	(467)	5
Other movements					15
Closing balance	**723**	**1,765**	**117**	**2,605**	**474**

The main items for which Telefónica, S.A. recognizes temporary differences in assets and liabilities are the tax effects of impairment losses on some of its assets, principally investments in subsidiaries (see Note 8).

Deferred tax liabilities include 32 million euros corresponding to the tax amortization of goodwill generated on acquiring stakes in the Brazilian subsidiaries of Brasilcel, N.V. No impact has been recognized in profit and loss, pending the final decisions on the court and administrative proceedings relating to this matter, which at year-end remained open.

In accordance with article 12.3 of the revised Spanish Income Tax Law (TRLIS), as well as with transitional provision 29 of that law, a negative adjustment of 551 million euros was provisionally included in the Company s taxable income declared at 2011 year end, in connection with the decline in value of investees. Finally, using the subsidiaries definitive financial statements, 582 million euros was included in the income tax return for the impairment of investees for tax purposes. At December 31, 2011, 3,071 million euros was pending inclusion for reversal of the adjustment in future periods.

In 2011, the variation in equity of investees for which an impairment loss was recognized amounted to 13,880 million euros, primarily in respect of the Brazilian companies.

At the 2012 year end, a decrease of 790 million euros was provisionally incorporated in the Company s taxable income in connection with impairment of investees for tax purposes. At December 31, 2012 3,861 million euros is pending inclusion for reversal of the adjustment in future periods.

In 2012, the negative variation in equity of investees for which a provision was made amounts to 589 million euros, primarily in respect of the Brazilian and Mexican companies.

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

The calculation of the income tax expense and income tax payable for 2012 and 2011 is as follows.

Millions of euros	2012	2011
Accounting profit before tax	(2,205)	3,999
Permanent differences	(5,017)	(7,177)
Temporary differences:	4,619	658
Arising in the year	4,782	1,846
Arising in prior years	(163)	(1,188)
Tax result	**(2,603)**	**(2,520)**
Gross tax payable	(781)	(756)
Tax credits capitalized	(2)	(11)
Corporate income tax refundable	**(783)**	**(767)**
Temporary differences for tax valuation	(1,386)	(351)
Temporary differences derived from the consolidation process		153
Other effects	(714)	16
Corporate income tax accrued in Spain	(2,883)	(949)
Foreign taxes	48	38
Income tax	**(2,836)**	**(911)**
Current income tax	(851)	(718)
Deferred income tax	(1,985)	(193)

The permanent differences relate mainly to changes in investment write-down provisions recorded by the Tax Group companies included in the consolidated corporate income tax return, and to dividends received from Tax Group companies or foreign companies that meet certain requirements.

In addition, they include as a permanent difference the decrease in income tax expense derived from the tax amortization of financial goodwill for foreign shareholding acquisitions made before December 21, 2007. In 2012, this adjustment came to 28 million euros. This impact has been lessened as a result of the entry into force of Law 9/2011, which reduced the deductible portion of goodwill amortization under article 12.5 TRLIS (Corporate Income Tax Act) from 5% to 1% for 2011, 2012 and 2013. The effect is temporary: the 4% not amortized over those three years (12% in total) will be recovered by extending the deduction period from the original 20 years to 22.5 years.

Temporary differences mainly comprise adjustments on eliminating the tax base of impairment provisions and reversals of investment write-downs that are not tax deductible under article 12.3 of the Income Tax Law (LIS).

In 2012 and 2011, the Company capitalized 2 million euros and 11 million euros, respectively, of tax credits. The cumulative amount at year end principally reflects tax deductions for export activities and donations to non-profit organizations (approximately 291 million euros). Given that the tax balance was a negative balance in 2012, no deductions were offset during the year.

Other effects includes mainly the recognition of tax credits amounting to 458 million euros.

Table of Contents

17.3 Tax inspections and tax-related lawsuits

On February 8, 2012, the lawsuit filed against the Company in the Supreme Court in relation to the income tax inspections of the tax group in Spain from 1998 to 2000 came to an end. The Group s allegations were partially upheld by the Supreme Court. 110 million euros were finally paid, although part of this amount will be recoverable in the future as it relates to temporary differences which will be reversed in coming years.

On December 12, 2012, the National Court of Justice issued a ruling on the tax inspection for 2001 to 2004, accepting the tax losses incurred by the Group in relation to the transfer of certain interests in TeleSudeste, Telefónica Móviles México and Lycos as tax deductible. The other allegations were rejected, and the Company has filed an appeal with the Supreme Court on December 28.

Lastly, in 2012, the tax inspections for 2005 to 2007 for all taxes were completed, with the Company signing consent forms for 135 million euros of corporate tax, without having received the final proposal for the non-consent form for the items which the Company contests, as an appeal has been filed with the Large Taxpayers Central Office of the Spanish State Tax Agency.

Telefónica, S.A. therefore has income tax for 2008 and other taxes for 2009 open to inspection.

At 2012 year end, it is not expected that the final outcome of these assessments, lawsuits, and inspections in progress or pending for years open to inspection will require any additional significant liabilities to be recognized in Telefónica, S.A. s financial statements.

Note 18. Trade and other payables

The breakdown of Trade and other payables is as follows:

Million of euros	2012	2011
Suppliers	162	322
Other payables	158	71
Current income tax liabilities (Note 17)	89	14
Other payables to public administrations (Note 17)	30	33
Total	**439**	**440**

Trade payables

In performance of Telefónica s irrevocable undertaking of 2010 to give Fundación Telefónica a total of 280 million euros, in 2012 the Company made cash payments in the amount of 62 million euros (60 million in 2011).

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

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2012 and 2011 included payment periods of up to 75 and 85 days, respectively, as laid down in said law.

For reasons of efficiency and in line with general practice in the business, the Company has set payment schedules, whereby payments are made on set days. Invoices falling due between two payment days are settled on the following payment date in the schedule. This is not deemed to be a deferred payment.

Information on contracts entered into after Law 15/2010 took effect that exceed the maximum period established in this law is shown in the table below.

Payments to Spanish suppliers in 2012 and 2011 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

	2012	
Millions of euros	**Amount**	**%**
Payments made on time	332	95
Other	17	5
Total payments to commercial suppliers	**349**	**100**
Weighted average maturity exceeded (days)	32	
Deferrals at year-end that exceed the limit	4	

2011		
Millions of euros	**Amount**	**%**
Payments made on time	254	93
Other	19	7
Total payments to commercial suppliers	**273**	**100**
Weighted average maturity exceeded (days)	52	
Deferrals at year-end that exceed the limit	2	

At the date of authorization for issue of these financial statements, Telefónica had processed the outstanding payments, except in cases where an agreement with suppliers was being handled.

Note 19. Revenue and expenses

19.1 Revenue

a) Rendering of services

Telefónica, S.A. has contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2012 and 2011, Rendering of services to Group companies and associates included 603 million euros and 618 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica O2 Holding, Ltd. and Telefónica Internacional, S.A.U. Revenue received for this concept in 2012 and 2011 amounted to 23 million euros and 25 million euros, in each case, recognized under Rendering of services to Group companies and associates .

Revenues also include property rental income amounting to 50 million euros in 2012 and 52 million euros in 2011, mainly from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

b) Dividends from Group companies and associates

The detail of the main amounts recognized in 2012 and 2011 is as follows:

Millions of euros	2012	2011
Telefónica Internacional, S.A.U.	1,500	
Telefónica Móviles España, S.A.U.	1,435	1,980
Telefónica de España, S.A.U.	221	2,430
Telefónica Europe, plc.	575	715
Vivo Participaçoes, Ltda. and subsidiaries		553
Telefónica Czech Republic, a.s.	213	365
Latin American Cellular Holding, B.V.	38	218
Inversiones Telefónica Móviles Holding, Ltd. (Chile)	189	
Telefónica Brasil, S.A. (previously Telecommunicaçoes de Sao Paulo)	307	235
Sao Paulo Telecommunicaçoes	44	91
Telefónica Móviles Argentina, S.A. y Telefónica Móviles Argentina Holding, S.A.	140	179
Other companies	190	201
Total	**4,852**	**6,967**

c) Interest income on loans to Group companies and associates

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

Millions of euros	2012	2011
Telefónica Móviles México, S.A. de C.V.	104	145
Telefónica de España, S.A.U.	34	83
Telefónica de Contenidos, S.A.U.	75	
Other companies	62	47
Total	**275**	**275**

Interest income from Telefónica de Contenidos, S.A.U. corresponds to the participating loans extended to this company. In 2012, the subsidiary generated more than the minimum profit stipulated in the loan agreements above which it must pay interest. No interest was paid in 2011 as this minimum was not reached. Of the amount accrued in 2012, at the year end 70 million euros were receivable (see Note 8.5).

19.2 Non-core and other current operating revenues Group companies relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion. In 2012, the most notable bills passed on were to Telefónica de España, S.A.U. totaling 27 million euros, Telefónica Internacional, S.A.U. 21 million euros and Telefónica O2 Holding, Ltd 33 million euros. In 2011, the main bills passed on were to Telefónica Móviles España, S.A.U. (26 million euros) and to Telefónica de España, S.A.U. (48 million euros).

19.3 Personnel expenses and employee benefits

The breakdown of Personnel expenses is as follows:

Millions of euros	2012	2011
Wages, salaries and other personnel expenses	130	213
Pension plans (Note 4.h)	(6)	12
Social security costs	17	19
Total	**141**	**244**

In 2012, Wages, salaries and other personnel expenses includes 8 million euros of compensation payable during the year. In 2011, this caption included 61 million euros for estimated obligations arising from the collective labor force reduction program approved in Telefónica de España, S.A.U. and expected to be passed on to Telefónica, S.A., and for the estimated cost of certain voluntary redundancies approved in 2011.

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

Defined contribution of 4.51% of the participating employees base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España, S.A.U.) will be maintained.

Mandatory contribution by participants of a minimum of 2.2% of their base salary.

Individual and financial capitalization systems.

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

At December 31, 2012, 1,709 employees had signed up for the plan (1,717 employees in 2011). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 3 million euros in 2012 (4 million euros in 2011).

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

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 8 million euros in both 2012 and 2011.

In 2012, some executives left this Pension Plan for Senior Executives, leading to the recovery of the cost of the contributions corresponding to these executives amounting to 17 million euros.

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

The share-based payment plans are the following:

Telefónica, S.A. share plan: Performance Share Plan (PSP).

At the General Shareholders Meeting of Telefónica, S.A. on June 21, 2006, its shareholders approved the introduction of a long-term incentive plan for managers and senior executives of Telefónica, S.A. and other Telefónica Group companies. Under this plan, selected participants who met the qualifying requirements were given a certain number of Telefónica, S.A. shares as a form of variable compensation.

The term of the plan is six years It is divided into five phases, each three years long, beginning on July 1 (the Start Date) and ending on June 30 three years later (the End Date). At the start of each phase the number of shares to be awarded to plan beneficiaries is determined on the basis of their success in meeting targets set. The shares are delivered, assuming targets are met, at the End Date of each phase. Each phase is independent from the others. The first started on July 1, 2006 (with shares to be delivered in July 2009) and the fifth phase began on July 1, 2010 (with any shares earned being delivered from July 1, 2013).

Award of the shares is subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the three-year duration of each phase, subject to certain special conditions related to departures.

- The actual number of shares awarded at the end of each phase will depend on success in meeting targets and the maximum number of shares assigned to each executive. Success is measured by comparing the total shareholder return (TSR), which includes both share price and dividends offered by Telefónica shares, with the TSRs offered by a basket of listed telecoms companies that comprise the comparison group. Each employee who is a member of the plan is assigned at the start of each phase a maximum number of shares. The actual number of shares awarded at the end of the phase is calculated by multiplying this maximum number by a percentage reflecting their success at the date in question. This will be 100% if the TSR of Telefónica is equal to or better than that of the third quartile of the Comparison Group and 30% if Telefónica s TSR is in line with the average. The percentage rises linearly for all points between these two benchmarks. If the TSR is below average no shares are awarded.

June 30, 2011 marked the end of the third phase of this plan, which entailed the following maximum number of shares allocated:

	Number of shares	Unit fair value	End date
3rd phase July 1, 2008	5,286,980	8.39	June 30, 2011

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

	Number of shares	Unit fair value	End date
3rd phase July 1, 2008	1,248,067	8.39	June 30, 2011

With the maturity of the third phase of the plan on June 30, 2011 a total of 2,900,189 shares (corresponding to a total of 4,166,304 gross shares less a withholding of 1,266,115 shares at the choice of employees) were delivered to Telefónica Group Directors. The shares delivered were deducted from the Company s treasury shares in 2011 (see Note 11.1.a). The total net shares delivered to Telefónica, S.A. managers and executives were 922,266.

The third phase of the plan was partially covered through two financial instruments relating to 2,446,104 shares at a cost of 10.18 euros per share. The cost of the gross amount of shares delivered to the directors of each subsidiary was subsequently billed by Telefónica, S.A., as previously established, with a unit value of 8.39 euros per share. The tax obligations of the directors in each of their countries related to the increase in their personal income from the receipt of the incentive were met by each subsidiary and subsequently charged to Telefónica, S.A., which recognized the cost under Reserves for an amount of 19 million euros in 2011.

The fourth phase of the incentives plan expired on June 30, 2012, with no shares being awarded. The maximum number of shares assigned to this phase of the plan was as follows:

	Number of shares	Unit fair value	End date
4th phase July 1, 2009	6,356,597	8.41	June 30, 2012

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

	Number of shares	Unit fair value	End date
4th phase July 1, 2009	1,555,382	8.41	June 30, 2012

For the same phase of the plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4 million shares). The cost of the financial instrument is 36 million euros, equivalent to 8.41 euros per option. The instrument was cancelled with a charge to distributable reserves when this phase of the plan expired.

The maximum numbers of shares allotted at the beginning of each phase to the final phase which was outstanding at December 31, 2012, for the Telefónica Group as a whole, were as follows:

	No. of shares assigned	No. of shares outstanding at Dec 31, 2012	Unit fair value	End date
5th phase July 1, 2010	5,025,657	4,294,158	9.08	June 30, 2013

Of the total number of shares allotted and outstanding at year-end, those corresponding to Telefónica, S.A. employees, by phase, are as follows:

	No. of shares	No. of shares outstanding	Unit fair value	End date

	assigned	at Dec 31, 2012		
5th phase July 1, 2010	1,249,407	1,296,953	9.08	June 30, 2013

This plan is equity-settled via the delivery of shares to the executives, with a balancing entry for the 13 million euros of employee benefits expense recorded in 2012 (15 million euros in 2010) in equity, net of the related tax effect.

The cost of the shares granted to employees of Group subsidiaries is recognized under Reserves and amounted to 26 million euros in 2012 (53 million euros in 2011). As Telefónica, S.A. will reinvoice these amounts to its subsidiaries at the maturity of the fifth phase, the related receivable is recognized under Other current financial assets (see Note 8.6).

a) Telefónica, S.A. share plan: Global Employee Share Plan (GESP)

At the June 23, 2009 General Shareholders Meeting of Telefónica, S.A. , the shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees of the Telefónica Group worldwide, with certain exceptions. Under this plan, participants who meet certain requirements are offered the possibility of acquiring shares in Telefónica, S.A., which takes up the obligation to give them a certain number of free shares.

The term of the plan is two years. Employees joining the plan can acquire Telefónica, S.A. shares through maximum monthly installments of 100 euros (or the local currency equivalent), up to a maximum of 1,200 euros over a period of 12 months (acquisition period). The delivery of shares occurred, where applicable, when the plan was consolidated, as of September 1, 2012, subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the two-year duration of the plan (consolidation period), subject to certain special conditions related to departures.

- The actual number of shares to be delivered at the end of the consolidation period depended on the number of shares acquired and retained by each employee. Each employee who is a member of the plan and remained a Group employee, and retained the shares acquired for an additional twelve-month period after the acquisition date, will be entitled to receive one free share per share acquired and retained at the end of the consolidation period.

On the consolidation date of the plan, 2,071,606 shares were awarded (corresponding to a total of 2,302,349 of gross shares of which 230,743 shares were retained at the request of the employees) to the 35,110 employees participating in the plan who were with the company on that date. This plan was equity-settled via the delivery of shares to the employees. Accordingly, a balancing entry for the employee benefits expenses was made in equity. In 2012, Telefónica, S.A. recognized an expense of 249 thousand euros for this item in its income statement (316 thousand euros in 2011).

b) Second edition of the Telefónica, S.A. global share plan: Global Employee Share Plan second edition (GESP II)

At the May 18, 2011 General Shareholders Meeting of Telefónica, S.A. , the shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees of the Telefónica Group worldwide, with certain exceptions. The characteristics and conditions of this plan are similar to those of the first edition approved at the General Shareholders Meeting in June 2009. The delivery of shares will be produced after the vesting date of the Plan after December 1, 2014.

The acquisition period opened in December 2012, and at December 31, 2012, 23,590 employees had adhered to the plan. This plan will be equity-settled via the delivery of shares to the employees. A balancing entry for the employee benefits expenses will primarily be made in equity in 2013 and 2014. The employee benefits expense in 2012 is immaterial.

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

At the General Shareholders Meeting held on May 18, 2011, a new long-term share-based incentive plan called Performance and Investment Plan (the Plan or PIP) was approved for Telefónica Group directors and executive officers. This plan will take effect following completion of the Performance Share Plan.

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

The Plan lasts five years and is divided into three independent three-year phases (i.e. delivery of the shares for each three-year phase three years after the start date). The first phase began on July 1, 2011 (with the delivery of the related shares from July 1, 2014). The second phase began on July 1, 2012 (with delivery of the related shares from July 1, 2015). The third phase will begin on July 1, 2013 (with delivery of the related shares from July 1, 2016).

The specific number of Telefónica, S.A. shares deliverable within the maximum amount established to each member at the end of each phase will be contingent and based on the Total Shareholder Return (TSR) of Telefónica, S.A. shares (from the reference value) throughout the duration of each phase compared to the TSRs of the companies included in the Dow Jones Global Sector Titans Telecommunications Index. For the purposes of this plan, these companies make up the comparison group (Comparison Group).

The TSR is the indicator used to determine the Telefónica Group s medium- and long-term value generation, measuring the return on investment for each shareholder. For the purposes of this plan, the return on investment of each phase is defined as the sum of the increase or decrease in the Telefónica, S.A. share price and dividends or other similar items received by the shareholder during the phase in question.

At the beginning of each phase, each Participant is allocated a notional number of shares. The number of shares to be delivered under the plan is expected to range from:

30% of the number of notional shares if Telefónica, S.A. s TSR is at least equal to the median of the Comparison Group, and

100% if Telefónica, S.A. s TSR is within the third quartile or higher than that of the Comparison Group. The percentage is calculated using linear interpolation when it falls between the median and third quartile.

No shares will be delivered if Telefónica, S.A. s TSR is below the Comparison Group s median.

The plan includes an additional condition regarding compliance by all or part of the Participants with a target investment and holding period of Telefónica, S.A. shares through each phase (Co-Investment), to be determined for each participant, as appropriate, by the Board of Directors based on a report by the Nominating, Compensation and Corporate Governance Committee. Participants meeting the co-investment requirement will receive an additional number of shares, provided the rest of the requirements established in the plan are met.

In addition, and independently of any other conditions or requirements that may be established, in order to be entitled to receive the corresponding shares, each Participant must be a Telefónica Group employee at the delivery date for each phase, except in special cases as deemed appropriate. Shares will be delivered at the end of each phase (i.e., in 2014, 2015, and 2016, respectively). The specific delivery date will be determined by the Board of Directors or the committee or individual entrusted by the Board to do so.

The shares to be delivered to Participants, subject to compliance with the pertinent legal requirements in this connection, may be either (a) treasury shares in Telefónica, S.A. acquired by Telefónica, S.A. itself or by any of the Telefónica Group companies; or (b) newly-issued shares.

The first and second allocations of shares under this plan were made on July 1, 2011 and July 1, 2012. The maximum number of shares assigned (including the amount of co-investment) under the plan for both phases is as follows:

	No. of shares assigned	No. of shares assigned at 12/31/12	Unit fair value	End date
1st phase July 1, 2011	5,545,628	4,984,670	8.28	June 30, 2014
2nd phase July 1, 2012	7,347,282	6,868,684	5.87	June 30, 2015

For the first phase of the Plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4 million shares). The cost of the financial instrument was 37 million euros, equivalent to 9.22 euros per option (see Note 9.4.1).

Table of Contents

19.4 Average number of employees in 2012 and 2011 and number of employees at year-end:

2012

	Employees at 12/31/12			Average no. of employees in 2012		
Professional category	**Females**	**Males**	**Total**	**Females**	**Males**	**Total**
General managers and chairmen		1	1		4	4
Directors	44	74	118	43	94	137
Managers	69	69	138	76	90	166
Project Managers	108	99	207	112	110	222
University graduates and experts	65	53	118	70	51	121
Administration, clerks, advisors	122	12	134	126	14	140
Total	**408**	**308**	**716**	**427**	**363**	**790**

2011

	Employees at 12/31/11			Average no. of employees in 2011		
Professional category	**Females**	**Males**	**Total**	**Females**	**Males**	**Total**
General managers and chairmen		4	4		4	4
Directors	41	147	188	40	138	178
Managers	95	131	226	91	112	203
Project Managers	97	153	250	89	125	214
University graduates and experts	93	54	147	89	50	139
Administration, clerks, advisors	158	20	178	160	20	180
Total	**484**	**509**	**993**	**469**	**449**	**918**

The reduction in the figures in 2012 compared to the prior year are primarily due to the fact that on April 1, 2012, Telefónica, S.A. made a contribution of an independent production unit (UPA for its initials in Spanish), which affected the employees into the digital business, who were transferred to Telefónica Digital España, S.L.

19.5 External services.

The items composing Finance revenue are as follows:

Millions of euros	**2012**	**2011**
Rent	11	11
Repairs and maintenance	(1)	4
Independent professional services	148	155
Bank charges	20	34
Donations	4	4
Marketing and advertising	87	86
Utilities	14	12
Other expenses	205	84
Total	**488**	**390**

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

Future minimum rentals payable under non-cancellable leases without penalization at December 31, 2012 and 2011 are as follows:

Millions of euros	Total	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Future minimum rentals 2012	**52**	5	9	10	28
Future minimum rentals 2011	**56**	5	9	10	32

19.6 Finance revenue

The items composing Finance revenue are as follows:

Millions of euros	2012	2011
Dividends from other companies	17	38
Other finance revenue	196	101
Total	**213**	**139**

Other finance revenue includes the 8 million euros in gains accrued from the equity swap contracts on the share price of Portugal Telecom (48 million euros in 2011).

In 2012, Other finance revenue also includes interest relating to the final income tax settlement for 2004 of 115 million euros.

19.7 Finance costs

The breakdown of Finance costs is as follows:

Millions of euros	2012	2011
Interest on borrowings from Group companies and associates	2,042	1,872
Finance costs payable to third parties and gains (losses) on interest rates of financial hedges	226	247
Total	**2,268**	**2,119**

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

Millions of euros	2012	2011
Telefónica Europe, B.V.	388	373
Telefónica Emisiones, S.A.U.	1,607	1,395
Other companies	47	104
Total	**2,042**	**1,872**

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

19.8 Exchange differences:

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

Millions of euros	2012	2011
On current operations	16	3
On loans and borrowings	414	251
On derivatives	927	1,567
On other items	15	16
Total	**1,372**	**1,837**

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

Millions of euros	2012	2011
On current operations	35	26
On loans and borrowings	173	982
On derivatives	1,073	927
On other items	50	40
Total	**1,331**	**1,975**

The change in exchange gains and losses is basically due to the US dollar strengthening against the euro by 1.93% in 2012 (weakening of 3.27% in 2011), and the pound sterling strengthening by 2.35% against the euro (3.05% in 2011).In the opposite way a weakening of 9.98% Brazilian real (8.27% in 2011).These impacts are offset by the hedges contracted to mitigate exchange rate fluctuations.

19.9 Impairment and gains (losses) on disposal of financial instruments

At year end, the values of the investments in Group companies and associates were reviewed based on the calculations of their future discounted cash flows. These reviews lead to a charge to impairment losses amounting to 5,312 million euros. The main impacts included in this figure are detailed in Note 8.2.

Note 20. Other information

a) Financial guarantees

At December 31, 2012, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 40,812 million euros (41,513 million euros at 2011 year end). These guarantees are measured in the Company s financial statements as indicated in Note 4.m).

Millions of euros

Nominal amounts	**2012**	**2011**
Debentures and bonds	37,719	33,819
Other marketable debt securities	827	3,596
Loans and other payables	2,266	4,098
Total	**40,812**	**41,513**

The debentures and bonds in circulation at December 31, 2012 issued by Telefónica Emisiones, S.A.U., Telefonica Europe, B.V. and Telefónica Finanzas México, S.A. de C.V. were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 37,719 million euros at December 31, 2012 (33,819 million euros at December 31, 2011). During 2012, Telefónica Emisiones, S.A.U. issued debt instruments on capital markets for an equivalent of 5,148 million euros (4,495 million euros in 2011); while Telefónica Emisiones, S.A.U. bonds equivalent to 618 million euros (3,023 million euros in 2011), Telefonica Europe, B.V. bonds of approximately 310 million euros, and Telefónica Finanzas México, S.A. de C.V. bonds of approximately 205 million euros matured.

The main loans and other debts guaranteed by Telefónica, S.A. at December 31, 2012 are: a line of credit entered into with China Development Bank on January 5, 2012 by Telefónica Europe, B.V., the outstanding principal of which at December 31, 2012 was 375 million US dollars (equivalent to 284 million euros); a syndicated loan granted on March 2, 2012 to Telefónica Europe, B.V. by various institutions, the principal of which at December 31, 2012 was equivalent to 801 million euros; and credit facilities obtained by Telefónica Finanzas, S.A. from the European Investment Bank, the outstanding principal of which at December 31, 2012 was equivalent to 766 million euros (824 million euros at December 31, 2011). In 2012, the syndicated loan granted to Telefónica Europe B.V. to acquire shares in O2, plc dated October 31, 2005 was rescheduled, with planned settlement dates of December 14, 2012 (Tranche D) and December 13, 2013 (Tranche E). Payment of approximately 1,300 million pounds sterling of the 2,100 million falling due in December 2012 was extended until December 2015, and 2,100 million pounds sterling falling due in December 2013 until March 2017. The outstanding balance of this syndicated loan at December 31, 2012 was 123 million euros (2,965 million euros at December 31, 2011). During 2012, 54 million euros of the credit facilities of Telefónica Finanzas, S.A.U. were repaid in accordance with their repayment schedules, while Tranche D of the syndicated loan obtained by Telefónica Europe, B.V. on October 31, 2005 fell due, the outstanding balance of which at December 31, 2011 was 2,459 million.

Other marketable debt securities includes the guarantee of Telefónica, S.A. relating to the commercial paper issue program of Telefonica Europe, B.V. The outstanding balance of commercial paper in circulation issued through this program at December 31, 2012 was 769 million euros (1,596 million euros at December 31, 2011). This caption also includes the remaining guarantee for preferred shares issued by Telefonica Finance USA, LLC, the redemption value of which amounts to 59 million euros (2,000 million euros at December 31, 2011).

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2012, these guarantees amounted to approximately 276 million euros.

b) Litigation

Telefónica and its Group companies are party to several lawsuits or proceedings that are currently in progress in the law courts and administrative and arbitration bodies of the various countries in which the Telefónica Group is present.

Considering the reports of the Company s legal advisors regarding these proceedings, it is reasonable to assume that this litigation or cases will not materially affect the financial position or solvency of Telefónica Group, regardless of the outcome.

Among unresolved cases or those underway in 2012 (see Note 17 for details of tax-related cases), the following are of special note:

Contentious proceedings in connection with the merger between Terra Networks, S.A. and Telefónica

On September 26, 2006, Telefónica was notified of the claim filed by former shareholders of Terra Networks, S.A. (Campoaguas, S.L., Panabeni, S.L. and others) alleging breach of contract in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. dated October 29, 1999. This claim was rejected via a ruling issued on September 21, 2009, and the appellants were charged for the court costs. This ruling was appealed on December 4, 2009. Telefónica opposed this appeal in January 2011. On November 7, 2011, case management directions were issued acknowledging receipt of the case file from the Commercial and Chancery Court and appointing the presiding judge. Since February 14, 2013, when the appeal was reviewed and ruled on, the Company is awaiting notification. It believes the ruling to be in favor of Telefónica s interests.

Appeal against the European Commission ruling of July 4, 2007 against Telefónica de España s broadband pricing policy.

On July 9, 2007, Telefónica was notified of the decision issued by the European Commission (EC) imposing a fine on Telefónica and Telefónica de España, S.A.U. of approximately 152 million euros for breach of the former article 82 of EC Treaty rules by charging unfair prices between whole and retail broadband access services. The ruling charged Telefónica with applying a margin squeeze between the prices it charged competitors to provide regional and national wholesale broadband services and its retail broadband prices using ADSL technology between September 2001 and December 2006.

On September 10, 2007, Telefónica and Telefónica de España, S.A.U. filed an appeal to overturn the decision before the General Court of the European Union. The Kingdom of Spain, as an interested party, also lodged an appeal to overturn the decision. Meanwhile, France Telecom and the Spanish Association of Bank Users (AUSBANC) filed requests to intervene, which the General Court admitted.

A hearing was held on May 23, 2011, at which Telefónica presented its case. On March 29, 2012 the General Court rules against the appeal by Telefónica and Telefónica de España, confirming the sanction imposed by the Commission. On June 13, 2012 an appeal against said ruling was lodged with the European Union Court of Justice.

In October 2007, Telefónica, S.A. presented a guarantee for an indefinite period of time to secure the principal and interest.

Case before the Directorate General for Competition of the European Commission Telefónica / Portugal Telecom

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

On January 23, 2012, the European Commission passed a ruling and imposed a fine on Telefónica, S.A. of 67 million euros, ruling that that Telefónica and Portugal Telecom committed an infraction as stipulated in Article 101 of the Treaty on the Functioning of the European Union (TFEU) having entered into the agreement set forth in Clause Nine of the aforementioned sales agreement.

Telefónica intends file an appeal for annulment of this ruling with the European Union General Court. The deadline for filing the appeal is April 9, 2013

c) Commitments

Atento

As a result of Telefónica s agreement to sell Atento announced on October 12, 2012 and ratified on December 12, 2012, both companies signed a Master Service Agreement regulating Atento s relationship with the Telefónica Group as a service provider for a period of nine years.

This agreement establishes Atento as Telefónica s preferred Contact Centre and Customer Relationship Management (CRM) service provider, stipulating annual commitments in terms of turnover which fluctuate in line with inflation and deflation that vary from country to country, pursuant to the current volume of services Atento has been providing to the entire Group.

Failure to meet the annual turnover commitments could result in compensation, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contract Centre s business margin to the final calculation.

Lastly, the Master Agreement sets forth a reciprocal arrangement, whereby Atento assumes similar commitments to outsource its telecommunications services to Telefónica.

d) Directors and senior executives compensations and other benefits

Board of Directors compensation

The compensation of Telefónica members of the Board of Directors is governed by Article 28 of the Bylaws, which states that the compensation amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the directors. This compensation, as laid down in said article of the Bylaws, is compatible with other professional or employment compensation accruing to the Directors by reason of any executive or advisory duties that they perform for the Company, other than the supervision and collective decision-making duties inherent in their capacity as Directors.

Accordingly, the shareholders, at the Annual General Shareholders Meeting held on April 11, 2003, set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros, including a fixed payment and fees for attending meetings of the Board of Director s Advisory or Control Committees. Total compensation paid to Telefónica s Directors for discharging their duties in 2012 amounted to 4,001,151 euros in fixed compensation and attendance fees.

The compensation of Telefónica, S.A. directors in their capacity as members of the Board of Directors, the Executive Commission and/or the Advisory and Control Committees consists of a fixed amount payable monthly, and fees for attending the meetings of the Board s Advisory or Control Committees. Executive Directors other than the Chairman do not receive any amounts for their directorships, but only the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

It is hereby stated that the Company s Board of Directors, at its meeting of July 25, 2012, agreed a 20% reduction of the amounts that the Board members receive for discharging their duties.

The tables below presents the fixed amounts established in 2012 for membership to Telefónica Board of Directors, Executive Commission and Advisory or Control Committees and the attendance fees of the Advisory or Control Committees.

Compensation of members of the Board of Directors and Board Committees

The amounts shown below are expressed in annual terms applicable up to the 20% reduction agreed by the Board of Directors on July 25, 2012.

Figures in euros

Post	Board of Directors	Executive Commission	Advisory or Control Committees (*)
Chairman	300,000	100,000	28,000
Vice Chairman	250,000	100,000	
Board member:			
Executive			
Proprietary	150,000	100,000	14,000
Independent	150,000	100,000	14,000
Other external	150,000	100,000	14,000

(*) In addition, the amounts paid for attendance at each of the Advisory or Control Committee s meetings is 1,250 euros.

Current compensation of members of the Board of Directors and Board Committees

The amounts shown below are expressed in annual terms applicable from the 20% reduction agreed by the Board of Directors on July 25, 2012 and effective for payments for the period between July 1, and December 31, 2012.

Amounts in euros

Position	Board of Directors	Executive Committee	Advisory or Control Committees (*)
Chairman	240,000	80,000	22,400
Vice Chairman	200,000	80,000	
Board member:			
Executive			
Proprietary	120,000	80,000	11,200
Independent	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(*) In addition, the amounts paid for attendance to each of the Advisory or Control Committee s meetings is 1,000 euros.

Individual breakdown

The following table presents the individual breakdown by item of the compensation and benefits paid by Telefónica, S.A. to member of the Company s Board of Directors in 2012:

Euros Director	Wage/ Compensation[1]	Fixed Payment Board Committees[2]	Attendance fees[3]	Short-term Variable Compensation[4]	Other items[5]	TOTAL 2012
Executive						
Mr. César Alierta Izuel	2,500,800	90,000		3,493,433	264,899	6,349,132
Mr. José María Álvarez-Pallete López	1,474,284			1,042,088	93,338	2,609,710
Ms. Eva Castillo Sanz	461,670	29,400	19,000		7,684	517,754
Mr. Santiago Fernández Valbuena						
Proprietary						
Mr. Isidro Fainé Casas	225,000	90,000			11,500	326,500
Mr. José María Abril Pérez	225,000	115,200	12,750			352,950
Mr. Antonio Massanell Lavilla	135,000	63,000	26,000		11,250	235,250
Mr. Ignacio Moreno Martínez	135,000					135,000
Mr. Chang Xiaobing	135,000					135,000
Independent						
Mr. David Arculus	105,000	19,600	4,500			129,100
Mr. Carlos Colomer Casellas	135,000	140,400	24,750		21,250	321,400
Mr. Peter Erskine	135,000	140,400	33,000		3,750	312,150
Mr. Alfonso Ferrari Herrero	135,000	190,800	50,750		21,500	398,050
Mr. Luiz Fernando Furlán	135,000	12,600	1,000			148,600
Mr. Gonzalo Hinojosa Fernández de Angulo	135,000	178,200	45,250		22,750	381,200
Mr. Pablo Isla Álvarez de Tejera	135,000	63,000	13,750			211,750
Mr. Francisco Javier de Paz Mancho	135,000	140,400	12,500		10,000	297,900

Other external						
Mr. Julio Linares López	1,688,216			5,966,275	25,159,663	32,814,154
Mr. Fernando de Almansa Moreno-Barreda	135,000	50,400	19,500		9,000	213,900

1 **Wage**: Cash compensation with a predefined payment frequency, accruable or not over time and payable by the Company contractually, irrespective of effective attendance by the Director of Telefónica, S.A. to Telefónica, S.A. Board Meetings. Includes non-variable remuneration accrued, as appropriate, by the Director for discharging any related executive duties.

2 **Fixed Payment Board Committees**: Amount of items other than attendance to meetings payable to Directors for membership to the Executive Committee or Advisory or Control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.

3 **Attendance fees**: Amounts payable for attendance to meetings of the Advisory or Control Committees of Telefónica, S.A.

4 **Short-term variable compensation**: Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year. For Mr. Julio Linares López, includes the amount of two annual payments (2011-2012).

5 **Other items**: Includes, inter alia ,(i) 24,748,696 euros in compensation paid to Mr. Julio Linares López on stepping down from his executive duties; and (ii) other amounts paid for membership of the various Regional Advisory Committees in Spain, and the Telefónica Corporate University Advisory Council.

With respect to the information contained in the preceding table, the following is noted: (i) On December 31, 2012, five years after he stopped performing executive duties in the Telefónica Group (as an employee and director), Mr. Peter Erskine was reclassified from Other external to Independent; (ii) on September 17, 2012, Mr. Julio Linares López resigned from his post as the Company s CCO of Telefónica, S.A. and his executive duties in the Telefónica Group and therefore being reclassified from Executive Director to Other external (iii) on September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent director to an Executive director, showing in the table the compensation as Chairwoman of Telefónica Europa from October 2012; (iv) on September 17, 2012, Mr. Santiago Fernández Valbuena was appointed Director of the Company as an Executive Director, with the compensation paid for his position Chairman of Telefónica Latinoamérica from October 2012 shown in the table Other amounts received from other Group Companies . The compensation paid to him as an Executive Director for his position as Chairman of Telefónica Latinoamérica from January to October 2012 is included under Senior executives compensation; and (v) on September 17, 2012, Mr. David Arculus stepped down as Director of the Company, with amount in the table showing the compensation paid to him until October 2012.

Table of Contents

In addition, to detail the amounts included in the preceding table, the following table presents the specific compensation paid to Directors of Telefónica for membership of the various Advisory or Control Committees in 2012, including both fixed payments and attendance fees:

Amounts in euros Directors	Audit and Control	Nomination, Compensation and Corporate Governance	Human Resources, Reputation and Corporate Responsibility	Regulation	Service Quality and Customer Service	International Affairs	Innovation	Strategy	TOTAL 2012
Mr. César Alierta Izuel									
Mr. Isidro Fainé Casas									
Mr. Julio Linares López									
Mr. José María Abril Pérez						14,850	23,100		37,950
Mr. José María Álvarez-Pallete López									
Mr. José Fernando de Almansa Moreno-Barreda				17,100		28,450		24,350	69,900
Mr. David Arculus				13,300		10,800			24,100
Ms. Eva Castillo Sanz				13,300	14,550			20,550	48,400
Mr. Carlos Colomer Casellas		19,850			17,350		37,950		75,150
Mr. Peter Erskine		23,100					23,350	36,950	83,400
Mr. Santiago Fernández Valbuena									
Mr. Alfonso Ferrari Herrero	23,100	36,700	17,350	17,100	18,350	14,600		24,350	151,550
Mr. Luiz Fernando Furlán						13,600			13,600
Mr. Gonzalo Hinojosa Fernández de Angulo	35,700	24,100	17,350		17,100	14,850		24,350	133,450
Mr. Pablo Isla Álvarez de Tejera		21,850	12,600	29,700	12,600				76,750
Mr. Antonio Massanell Lavilla	19,850		14,850		30,950		23,350		89,000
Mr. Ignacio Moreno Martínez									
Mr. Francisco Javier de Paz Mancho			29,950	17,100		15,850			62,900
Mr. Chang Xiaobing									
TOTAL	**78,650**	**125,600**	**92,100**	**107,600**	**110,900**	**113,000**	**107,750**	**130,550**	**866,150**

On the other hand, the following table presents a breakdown of the amounts received from other Telefónica Group companies other than Telefónica, S.A., by Company s Directors for discharging executive duties or for membership of the companies governing bodies and/or Advisory Boards of such companies:

Euros	Wage/compensation[1]	Attendance fees[2]	Short-term variable	Other items[4]	TOTAL

Director		compensation[3]		
Executive				
Ms. Eva Castillo Sanz	48,034		136,500	184,534
Mr. Santiago Fernández Valbuena	361,143		48,605	409,748
Independent				
Mr. David Arculus			63,565	63,565
Mr. Peter Erskine			84,754	84,754
Mr. Alfonso Ferrari Herrero	100,950		175,500	276,450
Mr. Luiz Fernando Furlán	105,991		175,500	281,491
Mr. Gonzalo Hinojosa Fernández de Angulo	17,322			17,322
Mr. Francisco Javier de Paz Mancho	658,688		175,500	834,188
Other external				
Mr. Fernando de Almansa Moreno-Barreda	216,293		175,500	391,793

1 **Wage**: Cash compensation with a predefined payment frequency, whether or not consolidable over time, and payable by Group companies in consideration of the mere fact of employment by them, regardless of the Director s attendance to Board meetings or analogous of the Telefónica Group entity in question. Also includes non-variable remuneration accrued, as appropriate, by the Director for discharging executive duties.

2 **Attendance fees**: Amounts payable for attendance to meetings of the Board of Directors or similar bodies of any Telefónica Group company.

3 **Short-term variable compensation**: Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year.

4 **Other items**: Includes, *inter alia,* amounts paid for membership of Regional Advisory Committees.

With respect to employee benefits, the following table presents a breakdown of contributions made in 2012 to both long-term savings schemes (including retirement and any other survival benefit) financed fully or partially by the Company for Telefónica Directors, for discharging executive duties, along with any other compensation in kind received by the Director during the year:

Euros **Director (Executive)**	**Contributions to pension plans**	**Contribution to the Pension Plan for Senior Executives[2]**	**Compensation in kind[3]**
Mr. Cesar Alierta Izuel	8,402	1,014,791	45,917
Mr. Julio Linares López	9,468	474,895	39,141
Mr. José María Álvarez-Pallete López	7,574	414,716	12,765
Ms. Eva Castillo Sanz	8,402	98,443	1,617
Mr. Santiago Fernández Valbuena[1]		110,112	6,564

1 The contribution to the Pension Plan was made when Mr. Fernández Valbuena was not an Executive Director and is therefore shown under Senior Executives Compensation. The amount was 8,402 euros.

2 Contributions to the Pension Plan for Executives set up in 2006, funded exclusively by the Company to complement the existing Company s general Pension Plan. It entails defined contributions equivalent to a certain percentage of the Directors fixed remuneration in accordance with their professional category within the Telefónica Group s organization.

3 Compensation in kind includes life and other insurance premiums (e.g. general medical and dental insurance).

Regarding share-based payment plans (those exclusively for Executive Directors), there were two long-term variable compensation plans in place in 2012:

(i) The Performance Share Plan (PSP) approved at the General Shareholders Meeting of June 21, 2006, whose fifth and final phase began in 2010 and will conclude in July 2013. The shares assigned were as follows: 170,897 shares to Mr. César Alierta Izuel, 128,173 shares to Mr. Julio Linares López, 77,680 shares to Mr. José María Álvarez-Pallete López and 77,680 shares to Mr. Santiago Fernández Valbuena. Delivery of the shares assigned are subject in all cases to meeting the target Total Shareholder Return (TSR) and the other requirements of the Plan.

Also, it is hereby stated that regarding the fourth phase of this Plan (2009-2012), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to Executive Directors.

(ii) The so-called Performance & Investment Plan (PIP) approved at the General Shareholders Meeting of May 18, 2011 whose first phase began in 2011 and will end in July 2014, and the second phase began in 2012 and will end in July 2015. It is hereby stated that the number of shares assigned and the maximum possible number of shares to be received by the Directors of Telefónica for discharging executive duties in each phase, if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met, are as follows:

First phase / 2011-2014

Name	Theoretical shares assigned	Maximum number of shares *
Mr. César Alierta Izuel	249,917	390,496
Mr. Julio Linares López	149,950	234,298
Mr. José María Álvarez-Pallete López	79,519	124,249
Mr. Santiago Fernández Valbuena	79,519	124,249

* Maximum possible number of shares to be received if the co-investment requirement and maximum target TSR are met.

Second phase / 2012-2015

Name	Theoretical shares assigned	Maximum number of shares *
Mr. César Alierta Izuel	324,417	506,901
Mr. Julio Linares López (1)	13,878	21,685
Mr. José María Álvarez-Pallete López	188,131	293,955
Ms. Eva Castillo Sanz	95,864	149,787
Mr. Santiago Fernández Valbuena	103,223	161,287

(1) The number of shares assigned to Mr. Linares was calculated in proportion to the time he discharged executive duties as Chief Operating Officer COO- (from July 1, 2012 to September 17, 2012) during the second phase of the Plan.

* Maximum possible number of shares to be received if the co-investment requirement and maximum target TSR are met.

In addition, to reinforce Telefónica s status as a global employer, with a common remuneration culture throughout the Company, to encourage all Group employees to take an equity interest, and to motivate employees and boost their loyalty, at the Company s General Shareholders Meeting of June 23, 2009, shareholders approved the introduction of a Telefónica, S.A. share incentive plan, the Global Employee Share Plan (GESP) for all employees of the Group worldwide (including executives and Executives Directors).

Under this plan, employees that meet the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, for a period of up to 12 months (the acquisition period), with this company assuming the obligation of giving participants a certain number of shares free of charge. The maximum sum each employee can assign to this plan is 1,200 euros, while the minimum is 300 euros. Employees who remain at the Telefónica Group and retain their shares for an additional year after the acquisition period (the consolidation period) will be entitled to receive one free share per share acquired and retained until the end of the consolidation period.

During the first phase of this Plan (2010-2011), Directors participating, as they discharged executive duties in the Group, acquired a total of 604 shares (including free shares received under the general terms and conditions of the Plan).

For the second phase of the Plan (2012-2013), approved at the General Shareholders Meeting of May 18, 2011, the Executive Directors that decides to take part contributing the maximum (i.e. 100 euros a month, over 12 months), at the date of finalization of these consolidated financial statements, had acquired, under this Plan, a total of 84 shares, entitling them to receive an equivalent number of free shares provided, *inter alia,* that they hold the share acquired throughout the consolidation period.

It should be noted that the external Directors do not receive and did not receive in 2012 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to Telefónica s share price.

In addition, the Company does not grant and did not grant in 2012 any advances, loans or credits to the Directors, or to its top executives, thus complying with the requirements of the U.S.A. Sarbanes-Oxley Act, which is applicable to Telefónica as a listed company in that market.

Senior executives compensation

Meanwhile, the Executives considered as Senior Executives[1] of the Company in 2012, excluding those that are also members of the Board of Directors, received a total, in 2012, of 24,321,976 euros. It is hereby stated that this amount includes, *inter alia*, 10,893,244 euros corresponding to the amounts received by Mr. Luis Abril Pérez and Mr. Calixto Rios Pérez in termination benefits, as a result of termination of their employment relationship with the Telefónica Group.

In addition, the contributions by the Telefónica Group in 2012 with respect to the Pension Plan described in Note on Revenue and Expenses for these Executives amounted to 1,392,798 euros. Contribution to the Pension Plan amounted to 48,730 euros and compensation in kind including life and other insurance premiums (e.g. general medical and dental insurance) to 93,460 euros.

Meanwhile, a total of 297,141 shares corresponding to the fifth phase (2010-2013) of the above mentioned Performance Share Plan (PSP) were assigned to the Executives considered as Senior Executives of the Company. Also, it is hereby stated that regarding the fourth phase of this Plan (2009-2012), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to the Executives.

Regarding the above mentioned Performance and Investment Plan (PIP) approved at the General Shareholders Meeting of May 18, 2011, a total of 422,344 shares were assigned to the Executives considered Senior Executives of the Company in the first phase (2011-2014) and 623,589 shares in the second phase (2012-2015).

Finally, regarding the first phase of the Global Employee Share Plan (GESP) (2010-2011), Executives participating acquired a total of 872 shares (including free shares received under the general terms and conditions of the Plan).

Regarding the second phase of the Plan (2012-2013), approved at the General Shareholders Meeting of May 18, 2011, the Executives taking part and contributing the maximum (i.e. 100 euros a month, over 12 months), at the date of finalization of these consolidated financial statements, had acquired, under this Plan, a total of 110 shares, entitling this Executives to receive an equivalent number of shares free provided, *inter alia,* that they hold the share acquired throughout the consolidation period established in the Plan.

(1) For these purposes, Senior Executives are understood to be individuals who perform senior management functions reporting directly to the management bodies, or their executive committees or CEOs, including the person in charge of the internal audit.

e) Detail of equity investments, positions held and duties performed in companies engaging in an activity that is similar or complementary to that of the Company

Pursuant to Section 229 of the consolidated Corporate Enterprises Act, introduced by Royal Legislative Decree 1/2010 of July 2, details are given below of (i) the direct and indirect interests held by members of the Board of Directors of Telefónica, S.A., and by persons related thereto as set out in Section 231 of the consolidated Corporate Enterprises Act and (ii) the positions or duties carried out by those individuals, both of the foregoing in respect to companies with the same, analogous, or similar corporate purpose as that of Telefónica, S.A.

Name	Activity performed	Company	Position or functions	Stake (%) (*)
Mr. Isidro Fainé Casas	Telecommunications	Abertis Infraestructuras, S.A.	Vice Chairman	< 0.01%
Mr. Isidro Fainé Casas	Telecommunications	Telecom Italia, S.p.A.		< 0.01%

(*) Shareholding of less than 0.01% of share capital indicated by <0.01% .

Information on Board member Chang Xiaobing, Executive Chairman of China Unicom (Hong Kong) Limited, is not included in this section given that:

In accordance with Article 26 bis of the Company s Bylaws, whereby (...) the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (...) companies with which Telefónica, S.A. maintains a strategic alliance , Mr. Xiaobing s interests are not in conflict with those of Telefónica, S.A.

Mr. Xiaobing holds no stakes in the capital of the companies in which he is a Board member (Section 229 of the Corporate Enterprises Act).

In addition, for information purposes, details are provided below on the positions or duties performed by members of the Board of Directors of Telefónica, S.A. in those companies whose activity is identical, similar or complementary to the corporate purpose of the Company, of any Telefónica Group company, or of any company in which Telefónica, S.A. or any of its Group companies holds a significant interest whereby it is entitled to board representation in those companies or in Telefónica, S.A.

Name	Company	Position or functions
Mr. César Alierta Izuel	Telecom Italia, S.p.A.	Director
	China Unicom (Hong Kong) Limited	Director
Mr. Julio Linares López	Telecom Italia, S.p.A.	Director
Mr. Alfonso Ferrari Herrero	Telefónica Chile, S.A.	Acting Director
	Telefónica del Perú, S.A.A.	Director
Mr. Francisco Javier de Paz Mancho	Telefónica Brasil, S.A.	Director
	Telefónica de Argentina, S.A.	Director
Mr. José Fernando de Almansa Moreno-Barreda	Telefónica Brasil, S.A.	Director
	Telefónica Móviles México, S.A. de C.V.	Director
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
Ms. María Eva Castillo Sanz	Telefónica Czech Republic, a.s.	Chairwoman of Supervisory Board
	Telefónica Europe, Plc.	Chairman
	Telefónica Deutschland Holding, A.G.	Chairman of Supervisory Board
Mr. Santiago Fernández Valbuena	Telefónica Internacional, S.A.	Chairman
	Telefónica América, S.A.	Chairman
	Telefónica Brasil, S.A.	Vice Chairman
	Telefónica Móviles México, S.A. de C.V.	Vice Chairman
	Colombia Telecomunicaciones, S.A., E.S.P.	Director
	Telefónica Chile, S.A.	Acting Director
	Telefónica Capital, S.A.	Sole Director
Mr. Chang Xiaobing	China United Network Communications Group Company Limited	Chairman
	China United Network Communications Corporation Limited	Chairman
	China Unicom (Hong Kong) Limited	Executive Chairman
	China United Network Communication Limited	Chairman

f) Related-party transactions

Significant shareholders

The main transactions between Telefónica, S.A. and its significant shareholders always concluded at arm s length are as follows: The figures refer to Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries pertaining to its consolidated group and Caja de Ahorros y Pensiones de Barcelona, (La Caixa) and subsidiaries pertaining to its consolidated group:

Millions of euros **2012**	**BBVA**	**Caixa**
Financial expenses	5	5
Receipt of services	28	25
Total expenses	**33**	**30**
Financial revenues	4	2
Dividends received	16	
Total revenues	**20**	**2**
Financing transactions	449	385
Guarantees granted		10
Time deposits	622	618
Dividends distributed	286	135
Derivatives	12,905	2,661

Millions of euros **2011**	**BBVA**	**Caixa**
Financial expenses	6	8
Receipt of services	2	1
Total expenses	**8**	**9**
Financial revenues	3	3
Dividends received	9	
Total revenues	**12**	**3**
Financing transactions	232	355
Guarantees granted	1	
Time deposits	277	298
Dividends distributed	514	366
Derivatives	23,275	800

Dividends received from BBVA relate to the interest Telefónica, S.A. holds in this company, as disclosed in Note 9.

Group companies

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

The balances and transactions between the Company and these subsidiaries at December 31, 2012 and 2011 are detailed in the notes to these individual financial statements.

Directors and senior executives

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

Compensation and other benefits paid to members of the Board of Directors and senior executives, as well as the detail of the equity interests and positions held and duties performed in companies engaging in an activity that is identical, similar or complementary to that of the Company are detailed in Note 20.d and e) to these financial statements.

g) Auditors fees

The fees paid in 2012 and 2011 to the various member firms of the Ernst & Young international organization, to which Ernst & Young, S.L. (the auditors of Telefónica, S.A. in 2012 and 2011) belongs, amounted to 3.15 million euros and 4.34 million euros, respectively, broken down as follows.

Millions of euros	2012	2011
Audit services	2.53	4.03
Audit-related services	0.62	0.31
Total	**3.15**	**4.34**

Ernst &Young, S.L. has not provided the Company with tax advice or other services except as disclosed above.

h) Environmental matters

As head of the Telefónica Group, Telefónica, S.A. engages in environmental management activities and projects in line with its environmental strategy. In 2012 and 2011, expenditure and investment for non-material amounts were recognized in the income statement and balance sheet, respectively.

The Group has launched various projects aimed at improving current systems to reduce the environmental impact of its existing installations, with project costs being added to the cost of the installation to which the project relates.

In addition, in line with its commitment to the environment, the Group announced the creation of a Climate Change Office to provide a framework for strategic and R&D and innovation projects in the quest for energy efficient solutions. This initiative entails the launch and implementation of solutions in each area that contribute to optimizing the Company s processes (operations, suppliers, employees, customers and society).

In the area of operations, the main objective is to develop and implement projects that will allow for more efficient networks and systems by reducing and optimizing energy consumption.

In the area of suppliers, active efforts are underway to include energy efficiency criteria in the purchasing process for all product lines in the Telefónica value chain.

In the area of employees, the aim is to foster among the Company s employees a culture of respect and awareness regarding the environment and energy saving.

In the area of customers, work is being carried out to better leverage ICTs (information and communication technologies) and increase energy efficiency with the objective of reducing carbon emissions.

And finally, in the area of society, the objective is to promote change in citizens behavior through Telefónica s actions.

The Company has also rolled out internal control mechanisms sufficient to pre-empt any environmental liabilities that may arise in future, which are assessed at regular intervals either by Telefónica staff or renowned third-party institutions. No significant risks have been identified in these assessments.

i) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued (see Note 16.b).

j) Contribution of business unit to Telefónica Digital España, S.L. (formerly Terra Networks Asociadas, S.L.)

On December 14, 2011, the Board of Directors of Telefónica, S.A. authorized the contribution of the digital business unit to Telefónica Digital España, S.L., including assets, accounts receivable and accounts payable, and staff dedicated to that business. The contribution was finally completed on April 1, 2012.

k) Disclosures pursuant to Law 16/2012 on revaluation of fixed assets

At the date of preparing these annual accounts, the Company is analyzing the need to revaluate its fixed assets pursuant to law 16/2012, of December 27, 2012. On concluding this analysis, the decision will be submitted for approval at the General Shareholders Meeting to enable shareholders to ratify the decision. If the revaluationt is approved, any accounting effects will be recognized with effect from January 1, 2013.

Note 21. Cash flow analysis

Cash flows from/(used in) operating activities

The loss before tax in 2012 amounted to 2,205 million euros (see the income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year.

These adjustments relate mainly to:

Impairments to investments in Group companies, associates and other investments of 5,312 million euros (impairment in 2011 of 1,606 million euros).

Declared dividends as income in 2012 for 4,852 million euros (6,967 million euros in 2011), interest accrued on loans granted to subsidiaries of 275 million euros in both years and a net financial expense of 2,126 million euros (2,314 million euros in 2011), adjusted initially to include only movements related to cash inflows or outflows during the year under Other cash flows from operating activities.

Other cash flows from operating activities amounted to 1,832 million euros (6,305 million euros in 2011). The main items included are:

a) Net interest paid:

Payments of net interest and other financial expenses amounted to 2,007 million euros (1,405 million euros in 2011), including:

Net payments to external credit entities of 190 million euros (130 million euros in 2011), and

Interest and hedges paid to Group companies of 1,817 million euros (1,535 million euros in 2011). The main payments in 2012 were to Telefónica Emisiones, S.A.U., for 1,450 million euros, and to Telefónica Europe, B.V., for 404 million euros.

b) Dividends received:

The main receipts relate to:

Millions of euros	**2012**	**2011**
Telefónica de España, S.A.U.	221	2,430
Telefónica Móviles España, S.A.U.	1,435	1,980
Telefónica Europe, plc.	574	715
Telefónica Czech Republic, a.s.	212	360
Vivo participaçoes		517
Telefónica Brasil, S.A. (Telesp)	347	151
Grupo Telefónica Móviles Argentina	112	179
Sao Paulo Telecommunicaçoes	51	170
Otros cobros de dividendos	385	571

Total	**3,337**	**7,073**

In addition to the dividends recognized as income in 2012 (see Note 19.1) and collected in the same period, this caption also includes dividends from 2011 collected in 2012.

c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. Payments of totaling 247 million euros were made in 2012, as disclosed in Note 17 (no payments on account were made in 2011). In this regard, the main amounts passed on to subsidiaries of the tax group were as follows:

Telefónica Móviles España, S.A.U.: rebilling of 360 million euros, corresponding to: 262 million euros for the 2011 income tax settlement and 98 million in payments of account of 2012 income tax. In 2011, rebilling amounted to 235 million euros for payments on account of 2010 income tax.

Telefónica de España, S.A.U.: rebilling of 573 million euros, corresponding to: 382 million euros for the 2011 income tax settlement, 25 million euros for the 2005 to 2007 tax settlements, and 166 million in payments of account of 2012 income tax. In 2011, rebilling amounted to 369 million euros for payments on account of 2010 income tax.

Cash flows from/(used in) investing activities

Payments on investments under Cash flows from/(used in) investing activities included a total payment of 6,779 million euros (3,554 million euros in 2011). The main transactions to which these payments refer are as follows:

Capital increases: The main disbursements are 1,081 million euros to Telfin Ireland, Ltd, 703 million euros to Telefónica Global, B.V., and 405 million euros to Inversiones Móviles Holding, S.A.(Chile), among others. These cash flows are disclosed fully in Note 8.1.a.

Buyback from shareholders of preference shares of Telefónica Finance, LLC, accepted in exchange for its interests as disclosed in Note 11.1.a) amounting to 1,941 million euros. This payment is offset by the amount received from the issue of new debentures (included as cash flows from financing activities) of 1,164 million euros, and the outflow of treasury shares recognized as payments for equity instruments of 776 million euros.

Buyback of debentures and bonds issued by Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V. totaling 458 million euros.

638 million euro loan awarded and paid out in 2012 to Telefónica Móviles España, S.A.U. described in Note 8.5.

Increase in financing to Telco, S.p.A. subsequent to the refinancing agreement described in Note 8.5.

This caption also includes payments in respect of share options, etc.

Proceeds from disposals totaling 8,151 million euros in 2012 (2,319 million euros in 2011) includes:

Repayments of loans granted by Telefónica, S.A. to subsidiaries, the most significant amounts of which in 2012 were received from Telefónica de España, S.A.U. (681 million euros).

Repayment of contributions through share capital reductions or share premiums by subsidiaries in 2012: 5,729 million euros from O2 Europe, Ltd, 731 million euros from Telefónica de España, S.A.U., 652 million euros from Inversiones Móviles Holding, S.A. (Chile), 144 million euros from Telefónica Czech Republic, a.s., primarily. All repayments of funds are recognized under Disposals and Dividends in the Financial investments in Group companies and associates table in Note 8.1 b).

In 2011, Proceeds from disposals primarily included repayment of loans granted by the Company to subsidiaries, the most significant amounts of which were received from Telefónica de España, S.A.U. (681 million euros), Telefónica Internacional, S.A.U. (700 million euros), and Inversiones Telefónica Móviles Holding (Chile) (50 million euros).

Cash flows from/(used in) financing activities

This caption includes the following items:

i. Payments for equity instruments of 590 million euros (377 million euros in 2011), relating to the net amount of treasury shares acquired in 2012 (Note 11).

ii. Proceeds from financial liabilities:

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

Millions of euros	2012	2011
8bn syndicated loan	915	2,000
Bilateral credit (Note 14.2)	200	
EKN credit facility (Note 14.2)	200	267
Telefónica Emisiones, S.A.U. (Note 15)	5,148	4,387
Telefónica Europe, B.V. (Note 15)	2,604	
Preferred shares TFinance (Note 14)	1,165	
Telfisa Global, B.V. financing (Note 15)		742
Commercial paper (Note 13)	244	
Other collections	489	137
Total	**10,964**	**7,553**

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

Millions of euros	2012	2011
Cesky syndicate loan (Note 14.2)		300
8bn syndicated loan	915	
Telefónica Europe, B.V.	4,508	15
Telefónica Finanzas, S.A.U.	1,544	1,262
Telefónica Emisiones, S.A.U. (Note 15)	620	2,954
Telfisa Global, B.V. financing (Note 15)	510	
Promissory note program (Note 13)		255
Net movement in floating-rate credit facilities	423	
Other payments	681	335
Total	**9,201**	**5,121**

915 million euros of the 8,000 million euros syndicated loan was repaid during the year. Subsequently a new drawdown on this loan was made for the same amount, and therefore the amount drawn down at both the beginning and end of the year is 8,000 million euros. Both movements are shown as issuance and repayment of debt in the accompanying tables and have no impact on the balance sheet at year end.

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

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

iii. Payments of dividends for 2,836 million euros (6,852 million euros in 2011). On May 14, 2012, it was resolved at the General Shareholders Meeting of Telefónica, S.A. to modify the prevailing dividends policy. This change involved paying part of the dividend in new shares in the Company rather than in cash (see Note 11.1.d.). The Company s Board of Directors also resolved in its meeting on July 25, 2012 to cancel the dividends scheduled for November 2012 and May 2013 as an extraordinary and one-off measure. Both these measures explain the difference in dividends distributed in 2012 compared to the previous year.

Note 22. Events after the reporting period

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

On January 22, 2013, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note (EMTN) registered with the Financial Services Authority (FSA) in London and updated on June 12, 2012, issued bonds for an aggregate amount of 1,500 million euros maturing on January 23, 2023. These bonds are guaranteed by Telefónica, S.A.

In January 2013, Telefónica made repayments for an aggregate amount of 1,830 million euros of the syndicated loan signed on July 28, 2010.

On February 4, 2013 Telefónica Emisiones, S.A.U. redeemed bonds that were issued on July 2, 2007, for an aggregate amount of 750 million US dollars and 850 million US dollars (approximately 1,213 million euros). These bonds were guaranteed by Telefónica, S.A.

On February 14, 2013 Telefónica Emisiones, S.A.U. redeemed bonds that were issued on October 31, 2004, for an aggregate amount of 1,500 million US dollars. These bonds were guaranteed by Telefónica, S.A.

On February 21, 2013, Telefónica, S.A. arranged financing for the purchase of capital goods worth 206 million euros maturing in 2016.

On February 22, 2013, Telefónica, S.A. arranged financing for the purchase of capital goods worth 1,001 million US dollars (approximately 759 million euros). At the date of authorization for issue of these financial statements, no amount of this financing had been drawn down.

On February 22, 2013, Telefónica, S.A. arranging refinancing of 1,400 million euros for Tranche A2 (initially for 2,000 million euros with expected maturity on July 28, 2014) of the 8,000 million euros syndicated loan arranged on July 28, 2010. This refinancing entails two tranches: a syndicated loan of 700 million euros maturing in 2017 and a syndicated loan of 700 million euros maturing in 2018.

Note 23. Additional note for English translation

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company s Directors in the meeting held on February 27, 2013. In the event of a discrepancy, the Spanish-language version prevails.

Table of Contents

2012 Financial Statements

Appendix I: Details of subsidiaries and associates at December 31, 2012

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	%OWNERSHIP Direct	 Indirect	 Capital	 Reserves	 Dividends received	INCOME (LOSS) From operations	 For the year	Gross carrying amount
Telefónica Europe plc (UNITED KINGDOM) Wireless communications services operator Wellington Street, Slough, SL1 1YP	100.00%		13	15,196	575	47	629	25,380
Telefónica Internacional, S.A. (SPAIN) Investment in the telecommunications industry abroad Gran Vía, 28 28013 Madrid	100.00%		2,839	8,863	1,500	(105)	302	8,132
Telefónica Móviles España, S.A.U. (SPAIN) Wireless communications services provider Plaza de la Independencia, 6 Pta. 5 28001 Madrid	100.00%		423	498	1,435	1,525	1,081	5,775
Telfin Ireland Limited (IRELAND) Intragroup financing 28/29 Sir John Rogerson s Quay, Dublin 2	100.00%			4,596			131	4,491
O2 (Europe) Ltd. (UNITED KINGDOM) Holding company Wellington Street, Slough, SL1 1YP	100.00%		1,239	628			5,610	3,050
Telefónica Móviles México, S.A. de C.V. (MEXICO) (1) Holding company Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, México D.F. CP.05349	100.00%		3,144	(2,457)		9	(145)	2,891
Telefónica de España, S.A.U. (SPAIN) Telecommunications service provider in Spain Gran Vía, 28 28013 Madrid	100.00%		1,024	1,193	221	2,864	1,887	2,303
Telefónica de Contenidos , S.A.U. (SPAIN) Organization and operation of multimedia service-related activities and businesses Don Ramón de la Cruz, 84 4ª Pta.- 28006 Madrid	100.00%		1,865	(1,653)		56	36	2,242
Telefónica Datacorp, S.A.U. (SPAIN) Telecommunications service provider and operator Gran Via, 28 28013 Madrid	100.00%		700	114		53	38	1,343
Telfisa Global, B.V. (NETHERLANDS) Integrated cash management, consulting and financial support for Group companies Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam	100.00%		703	2	3	(2)	8	705

Table of Contents

2012 Financial Statements

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	% OWNERSHIP Direct	Indirect	Capital	Reserves	Dividends received	INCOME (LOSS) From operations	INCOME (LOSS) For the year	Gross carrying amount
Ecuador Cellular Holdings, B.V. (NETHERLANDS) Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%			557	38		53	581
Telefónica Chile Holdings B.V. (NETHERLANDS) Holding company Herikerbergwebr 238, 1101CM 23393, 1100DW Amsterdam Zuidoost (Netherlands)	100.00%			1,464				473
Atento Inversiones y Teleservicios, S.A. (SPAIN) Telecommunications service provider C/ Santiago de Compostela, 94 28035 Madrid	100.00%		24	32	10	505	504	256
Panamá Cellular Holdings, B.V. (NETHERLANDS) Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%			44	21		21	238
Telefónica Centroamérica de Guatemala Holdings, S.A. (GUATEMALA) (1) Sociedad Holding Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 10 Ciudad de Guatemala	100.00%		278	(109)	16	15	4	237
Telefónica de Costa Rica TC, S.A. (COSTA RICA) Telecommunications mobile operator Plaza Roble, Edificio Los Balcones 4to. Piso, San José, Costa Rica	100.00%		201	(19)		(55)	(55)	201
Telefónica El Salvador Holding, S.A. de C.V. (EL SALVADOR) (1) Holding company Alameda Roosvelt y Avenida Sur. Torre Telefónica nivel 10 San Salvador	100.00%		149	(69)		6	1	161
Telefónica Global Technology, S.A. (SPAIN) Global management and operation of IT systems Gran Vía, 28 28013 Madrid	100.00%		13	78		(3)	(5)	155
Telefónica Capital, S.A. (SPAIN) Finance company Gran Via, 28 28013 Madrid	100.00%		7	137	27	(1)	(12)	110
Telefónica Digital España, S.L. (formerly Terra Networks Asociadas, S.L.) (SPAIN) Portfolio company Gran Via, 28 28013 Madrid	100.00%		9	9		(16)	(7)	92
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) Life insurance, pensions and health insurance Ronda de la Comunicación, s/n Distrito Telefónica Edificio Oeste 1, planta 9- 28050 Madrid	100.00%		51	58	5	4	12	69
Telefónica Digital Holdings, S.L. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica Edificio Central 28050 Madrid	100.00%		3	43				47
Guatemala Cellular Holdings, B.V. (NETHERLANDS) Holding company Strawinskylaan 3105, Atium 7th, Amsterdam	100.00%			49			2	30

Table of Contents

2012 Financial Statements

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	% OWNERSHIP Direct	 Indirect	 Capital	 Reserves	 Dividends received	INCOME (LOSS) From operations	 For the year	 Gross carrying amount
Taetel, S.L. (SPAIN) Acquisition, ownership and disposal of shares and stakes in other companies Gran Via, 28 28013 Madrid	100.00%		28	13	1		1	28
Telefónica Gestión de Servicios Compartidos España, S.A. (SPAIN) Management and administrative services rendered Gran Via, 28 28013 Madrid	100.00%		8	45		7	6	24
Lotca Servicios Integrales, S.L. (SPAIN) Holding and operation of aircraft and aircraft leases Gran Via, 28 28013 Madrid	100.00%		17	(5)			(1)	17
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) Security services and systems Condesa de Venadito, 1 28027 Madrid	100.00%		7	1		(3)	(2)	15
Comet, Compañía Española de Tecnología, S.A. (SPAIN) Promotion of business initiatives and holding of real estate assets Villanueva, 2 duplicado planta 1ª Oficina 23 28001 Madrid	100.00%		5	4				14
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN) Integrated cash management, consulting and financial support for Group companies Gran Vía, 30 4ª Plta. 28013 Madrid	100.00%		3	46	3	(1)	11	13
Telefónica Móviles Soluciones y Aplicaciones, S.A. (CHILE) IT and communications services provider Avenida del Cóndor Nº 720, piso 4, comuna de Huechuraba, Santiago de Chile	100.00%		10	(1)		1		11
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) Design of communications products Vía de Dos Castillas, 33 Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón 28224 Madrid	100.00%			N/D		N/D	N/D	10
Telefónica International Wholesale Services II, S.L. (SPAIN) Telecommunications service provider and operator Ronda de la Comunicación, s/n 28050 Madrid	100.00%			(26)		(39)	(27)	9
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN) Telecommunications research activities and projects Telecomunicaciones Ronda de la Comunicación, s/n 28050 Madrid	100.00%		6	49		12	10	6
Telefonica Luxembourg Holding S.à.r.L. (LUXEMBOURG) Holding company 26, rue Louvingny, L-1946- Luxembourg	100.00%		3	1			75	4
Venturini España, S.A. (SPAIN) Property leasing Avda. de la Industria, 17 Tres Cantos 28760 Madrid	100.00%		3	1				4

Table of Contents

2012 Financial Statements

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	% OWNERSHIP Direct	Indirect	Capital	Reserves	Dividends received	INCOME (LOSS) From operations	For the year	Gross carrying amount
Telefónica de Centroamérica, S.L. (SPAIN) Dormant company Gran Via, nº 28, 28013 Madrid	100.00%							1
Fisatel Mexico, S.A. de C.V. (MEXICO) Integrated cash management, consulting and financial support for Group companies Boulevard Manuel Avila Camacho, 24 16ª Plta. Lomas de Chapultepec 11000 Mexico D.F.	100.00%			2				
Telefónica Emisiones, S.A.U. (SPAIN) Integrated cash management, consulting and financial support for Group companies Gran Via, 28 28013 Madrid	100.00%			3		(3)	2	
Telefónica Europe, B.V. (NETHERLANDS) Fund raising in capital markets Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam	100.00%			5	2	(1)	1	
Telefónica Internacional USA Inc. (EE.UU.) Financial advisory services 1221 Brickell Avenue suite 600 33131 Miami Florida	100.00%			1				
Telefónica Latinoamérica Holding, S.L. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica 28050 Madrid	94.59%	5.41%	185	1,663			(1)	1,749
Telefónica International Wholesale Services, S.L. (SPAIN) International services provider Gran Via, 28 28013 Madrid	92.51%	7.49%	230	55		(6)	(1)	213
Corporation Real Time Team, S.L. (SPAIN) Internet design, advertising and consulting Claudio Coello, 32, 1º ext. Madrid	87.96%	12.04%		N/D		N/D	N/D	12
Telefónica Móviles Argentina Holding, S.A. (ARGENTINA) Holding company Ing Enrique Butty 240, piso 20-Capital Federal-Argentina	75.00%	25.00%	306	609	104	514	302	856
Telefónica International Wholesale Services America, S.A. (URUGUAY) Provision of high bandwidth communications services Luis A. de Herrera, 1248 Piso 4 Montevideo	74.36%	25.64%	562	(370)		(64)	(64)	325
Telefónica Czech Republic, a.s. (CZECH REPUBLIC)) (*) Telecommunications service provider Za Brumlovkou 266/2,140 22 Praga 4-Michle Ceska Republica	69.41%		668	1,246	213	319	255	3,370

Table of Contents

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	% OWNERSHIP Direct	 Indirect	 Capital	 Reserves	 Dividends received	INCOME (LOSS) From operations	 For the year	Gross carrying amount
Telefónica Móviles Panamá, S.A. (PANAMA) Wireless telephony services Edificio Magna Corp. Calle 51 Este y Avda Manuel María Icaza, Ciudad de Panamá	56.31%	43.69%	24	67	35	23	16	301
Aliança Atlântica Holding B.V. (NETHERLANDS) Portfolio company Strawinskylaan 1725 1077 XX Amsterdan	50.00%	43.99%	40	11			3	22
Sao Paulo Telecomunicaciones Participaçoes, Ltda (BRAZIL) Holding company Rua Martiniano de Caravalho, 851 20º andar, parte, Sao Paolo	44.72%	55.28%	3,813	41	44	(1)	280	3,092
Telefónica Móviles del Uruguay, S.A. (URUGUAY) Wireless communications and services operator Constituyente 1467 Piso 23, Montevideo 11200	32.00%	68.00%	10	265		88	82	13
Telefónica Brasil, S.A. (BRAZIL) (1)(*) Wireline telephony operator in Sao Paulo Sao Paulo	24.68%	49.28%	15,210	(1,413)	307	315	1,784	9,820
Colombia Telecomunicaciones, S.A. ESP (COLOMBIA) (1) Wireless operator Calle 100, Nº 7-33, Piso 15, Bogotá,Colombia	18.51%	51.49%	490	(1,571)		(46)	(314)	272
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN) Distribution, promotion or preparation of insurance contracts, operating as a broker Avda. General Perón, 38 Master II 17ª P.- 28020 Madrid	16.67%	83.33%			1	4	4	
Telefónica Móviles Argentina, S.A. (SPAIN) Wireless communications and services operator Ing Enrique Butty 240, piso 20-Capital Federal-Argentina	15.40%	84.60%	N/D	N/D	36	N/D	N/D	139
Telefónica Móviles Guatemala, S.A. (GUATEMALA) Provision of wireless, wireline and radio paging communications services Bulevar Los Próceres 20-09 Zona 10. Edificio Iberoplaza. Ciudad de Guatemala	13.60%	86.38%			2			38
Telefónica Gestión de Servicios Compartidos, S.A. (ARGENTINA) Management and administrative services rendered Av. Ing. Huergo 723 PB Buenos Aires	4.99%	95.00%	2	2		3	2	
Inversiones Telefónica Móviles Holding, Ltd. (CHILE) Holding company Miraflores, 130 12º Santiago de Chile	3.11%	96.89%	461	36	189		129	89

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	% OWNERSHIP Direct	Indirect	Capital	Reserves	Dividends received	INCOME (LOSS) From operations	For the year	Gross carrying amount
Telefónica de Argentina, S.A. (1) (ARGENTINA) Telecommunications service provider Av. Ingeniero Huergo, 723, PB Buenos Aires	1.80%	98.20%	185	266		200	119	23
Telefónica Venezolana, C.A. (VENEZUELA) (1) Wireless operator Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060	0.09%	99.91%	466	1,237		1,088	628	123
Telefónica Factoring España, S.A. (SPAIN) Factoring Pedro Teixeira, 8 28020 Madrid	50.00%		5	2	3	6	6	3
Telco, S.p.A. (ITALY) Holding company of a stake in Telecom Italia Galleria del Corso, 2 Milan	46.18%		1,785	865		(1)	(1,729)	2,592
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) Factoring México D.F.	40.50%	9.50%	2				1	1
Telefónica Factoring Perú, S.A.C. (PERÚ) Factoring Ciudad de Lima	40.50%	9.50%	1	1			1	1
Telefónica Factoring Colombia, S.A. (COLOMBIA) Factoring Bogotá	40.50%	9.50%	1	1		2	1	1
Telefónica Factoring Chile, S.A. (CHILE) Factoring Ciudad y Comuna de Santiago.	40.50%	9.50%				1	1	
Telefónica Factoring Do Brasil, Ltd. (BRASIL) Factoring Avda. Paulista, 1106 Sao Paulo	40.00%	10.00%	1	(2)	3	(2)	11	1
Jubii Europe N.V. (NETHERLANDS) (*) Internet portal In liquidation Richard Holkade 36, 2033 PZ Haarlem PAISES BAJOS	32.10%		N/D	N/D		N/D	N/D	15
Torre de Collçerola, S.A. (SPAIN) Operation of telecommunicatios mast and technical assistance and consulting services. Ctra. Vallvidrera-Tibidabo, s/nº 08017 Barcelona	30.40%		6					2
Otras participaciones					58			340
Total empresas del grupo y asociadas					**4,852**			**82,532**

(1) Consolidated data.
(*) Companies listed on international stock exchanges at December 31, 2012.

Table of Contents

Management report 2012

Economic results

The Telefónica Group is one of the world s leading mobile and fixed communications services providers. Its strategy is to become the leader in the new digital world and transform the possibilities it brings into reality.

Against this backdrop and with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances, in September 2011 a new organizational structure was approved. This new structure, which was fully operational in 2012, is as follows:

This new organization bolsters the Telefónica Group s place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its large customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica s transformation into a fully global group.

Telefónica Europe s and Telefónica Latin America s objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation. The Telefónica Group s growth strategy for the next few years is geared towards:

- Improving the customer experience to continue increasing the number of accesses.
- Leading growth:
  - Boosting the penetration of smartphones in all markets to accelerate the growth of mobile data, unlocking the value of its increased usage.
  - Defending the competitive position in the fixed line business with a focus on broadband, offering faster speeds, bundled offers, full IP voice and video services.
  - Leveraging growth opportunities arising in an increasingly digital environment, e.g. video, OTT, financial services, cloud computing eHealth, media.
- Continuing efforts to transform the Group s operating model:
  - Increasing network capacity in key markets through technological advances and acquisitions of spectrum.

Accelerating the transformation primarily through the systems area.

Proceeding towards becoming an international digital and online service provider group.

Maximizing economies of scale to boost efficiency.

The Telefónica Group has operations in Spain, the United Kingdom, Germany, the Czech Republic, Ireland and Slovakia in Europe, as well as Mexico and several countries in Central America, and Brazil, Venezuela, Colombia, Peru, Argentina, Chile, Uruguay and Ecuador in Latin America.

Telefónica has an industrial alliance with Telecom Italia, S.p.A. and a strategic alliance with China Unicom, in which the Group holds a 5% stake. In addition, the Partners Program was created in line with the objective of unlocking the value of Telefónica s scale. Three operators have already signed up for this program (Bouygues, Etisalat and Sunrise). This initiative makes a host of services available to selected operators under commercial terms that allow the partners to leverage on Telefónica s scale and to cooperate in key business areas (e.g. roaming, services to multinationals, procurement, handsets).

Results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 631 million euros in 2012. Highlights of the 2012 income statement include:

Decrease in revenue from operations year on year, primarily due to the following:

The lower amount of dividends received from Group companies and associates: The most significant differences relate to Telefónica de España, S.A.U. (221 million euros compared to 2,430 million euros in 2011) , Telefónica Europe, plc. (575 million euros compared to 715 million euros in 2011), Móviles España, S.A.U. (1,435 million euros compared to 1,980 million euros in 2011) and Vivo Participaçoes (in which Telefónica, S.A. did not have a direct investment in 2012 and which 2011 paid 553 million euros) of dividends. The reductions were offset partially by the 1,500 million euros of dividends received from Telefónica Internacional, S.A.U.

The decrease in royalties income from contracts signed in 2008 for use of the Telefónica brand, which stipulate a fixed percentage of turnover (prior to 2011, an increasing percentage had been applicable compared to the prior year), is due to the drop in income of the subsidiaries subject to these contracts.

Impairment and gains (losses) on disposal of financial instruments increased considerably compared to 2011 due to impairment charges recognized in 2012 mainly to investments in Telefónica O2 Europe, plc., for 3,682 million euros, and Telco, S.p.A., for 1,305 million euros.

Net financial expense totaled 2,126 million euros in 2012, compared to 2,314 million euros in 2011. This was mainly due to finance costs with Group companies and associates, of which the largest came from Telefónica Europe, B.V. amounting to 383 million euros (373 million euros in 2011) and Telefónica Emisiones, S.A.U. totaling 1,607 million euros (1,395 million euros in 2011).

Investment activity

2012

In April, 2012, Telefónica Móviles Colombia, S.A. (a company fully owned by the Telefónica Group), the Colombian government (hereinafter the Government) and Colombia Telecomunicaciones, S.A. ESP (a company 52% owned by Telefónica Group and 48% by the Government) reached a final agreement to restructure their wireline and wireless businesses in Colombia. The agreement led to the merger between Colombia Telecomunicaciones, S.A. ESP and Telefónica Móviles Colombia, S.A., resulting in Telefónica holding 70% of the share capital of the resulting company and the Government the remaining 30%, based on the valuations of the companies used to determine said shareholdings Telefónica, S.A. held a direct shareholding of 49.42% in Telefónica Móviles Colombia, S.A., holding 18.51% of the merged company after the merger. This transaction did not alter the cost of the investment held by the Company.

Telefónica started to reorganize its business in Latin America during 2012. As part of this process, on October 10, 2012 and November 7, 2012 two new companies Telefónica América, S.A. and Telefónica Latinoamérica Holding, S.L. were incorporated, both of which are jointly controlled by Telefónica, S.A. and Telefónica Internacional, S.A.U. On December 13, 2012, Telefónica Latinoamérica Holding, S.L. performed two consecutive capital increases. In the first, Telefónica, S.A. contributed its shareholding in Latin American Cellular Holdings, B.V. at its carrying amount of 1,749 million euros. In the second, Telefónica Internacional, S.A.U. contributed 100 million euros in cash. Telefónica, S.A. a held 94.59% in this company subsequent to the capital increase. In addition, on December 18, 2012, Telefónica, S.A. sold its non-controlling interest in Telefónica de Perú, S.A.A. to Telefónica Latinoamérica Holding, S.L. for 4 million euros. The share transfer was performed at the price quoted on the Peruvian stock market of 2.3 PEN per share, and gave rise to gains of 1 million euros, recognized under the income statement caption Gains (losses) on disposal and other gains and losses .

Telefónica has also commenced the reorganization of its subsidiaries in Chile. During the first quarter of 2012, Inversiones Telefónica Móviles Holding, Ltd. distributed a dividend in kind comprising the shareholding in Inversiones Telefónica Fija, S.A. at its net carrying amount totaling 67 million euros. This contribution is reflected as an addition in the table of moments for 2012. Meanwhile, on November 19, 2012, Telefónica Chile Holdings, B.V. was incorporated with share capital of 1 euro. On December 10, 2012, it increased its share capital, which was subscribed by the Company in exchange for the Company s shareholding in Inversiones Telefónica Fija, S.A. Finally, on December 24, 2012, Telefónica Chile Holdings, B.V. increased its share capital, subscribed in full by Telefónica, S.A. for 405 million euros, paid in cash.

In April 2012, Telefónica, S.A. subscribed to various share capital increases in Telefónica Móviles México, S.A. de C.V. totaling 1,668 million Mexican pesos (97 million euros) in order to provide the subsidiary with the funds needed to pay for the spectrum licenses acquired in 2011.

On May 31, 2012 the Board of Directors of Telefónica, S.A. ratified the refinancing proposal that Telco, S.p.A. had submitted for approval by its partners. This refinancing involved increasing share capital by 277 million euros and subscribing a bond of 208 million euros, as well as renewing the existing bond of 600 million euros

In September 2012, the share capital of Telfisa Global, B.V. was increased by 703 million euros. On September 11 and 13, 2012, the Company completed two capital increases in Telfin Ireland, Ltd. totaling 1,005 million euros. The aforementioned transactions were performed as part of the Group s reorganization of various subsidiaries in Europe, prior to the initial public offering (IPO) of Telefónica Germany, GmbH.

On November 22, 2012, Telfin Ireland, Ltd increased its capital again by 76 million euros, subscribed by the Company. These funds were then transferred to Telefónica O2 Holding, Ltd. as a loan to enable this subsidiary to meet its general financing requirements.

On December 5, Telefónica O2 Europe, Ltd resolved to pay back contributions totaling 5,729 million to its parent. This consideration was collected in December 2012.

On March 27, 2012, it was resolved at the Ordinary General Shareholders Meeting of Telefónica de España, S.A.U. to distribute dividends of 221 million euros and repay contributions of 731 million euros.

On November 12, 2012, it was resolved at the Extraordinary Shareholders Meeting of Inversiones Telefónica Móviles Holding, S.A. to reduce share capital by repaying contributions totaling 652 million euros. This consideration was collected in December 2012.

On 25 de mayo de 2012, it was resolved at the Ordinary General Shareholders Meeting of Telefónica Czech Republic, a.s. to reduce share capital by 4,187 million Czech crowns. Once the transaction had been approved by the state authorities, it was recognized by Telefónica, S.A. in November 2012, having an impact of 114 million euros, which was repaid by the subsidiary in December 2012.

On July 18, 2012, the State Department of Puerto Rico ratified the winding up of Telefónica Móviles Puerto Rico, Inc. The investment in this company was provisioned for in full at the time of its liquidation; therefore this event has not had an impact in the income statement.

In 2012, equity swap contracts were partially cancelled through the sale of 21 million shares in Portugal Telecom. The equity swap contracts with Credit Suisse and Mediobanca were fully cancelled. A loss of 34 million euros was incurred, which is recognized under *Gain (loss) on available-for-sale financial assets recognized in the period* .

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31.

As a result of these estimations and the effect of the net investment hedge in 2012, an impairment provision of 5,312 million euros was recognized. This amount derives mainly from the following companies: (a) the write-down recognized by Telefónica Europe, plc. (3,682 million euros), less 82 million euros for the effect of the net investment hedge and (b) the write-down of 1,305 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year. The write-down of Telefónica Europe, plc. is the result of the net impact of fluctuations in the sterling exchange rate and changes in the present value of expectations regarding the business of the subsidiary, which operates in several European markets.

2011

On March 25, 2011 the Boards of Directors of each of the subsidiaries controlled by Telefónica, Vivo Participações and Telesp, approved the terms and conditions of a restructuring process whereby all shares of Vivo Participações that were not owned by Telesp were exchanged for Telesp shares, at a rate of 1.55 new Telesp shares for each Vivo Participações share. These shares then became the property of Telesp, whereby Vivo Participações then became a wholly owned subsidiary of Telesp. The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders´ Meeting held on the same date following authorization by the Brazilian telecommunications regulator, Anatel.

At that date, Telefónica, S.A. held a direct stake of approximately 60% in Vivo Participaçoes, Ltda., valued at 13,021 million euros, subsequent to the liquidation by absorption of Portelcom Participaçoes, S.A., PTelecom Brasil, S.A. and Telefónica Brasil Sul Celular Participaçoes, Ltda.

On June 14, 2011, the Boards of Directors of Vivo Participações and Telesp approved a restructuring plan whose objective was to simplify the corporate structure of both companies and foster their integration, eliminating Vivo Participações from the corporate chain through the incorporation of its total equity into Telesp, and concentrating all mobile telephony activities in Vivo, S.A. (now a direct subsidiary of Telesp).

This deal was submitted for consideration by the Brazilian telecommunications regulator and finally approved at the General Shareholders Meetings of both companies on October 3, 2011. The company arising from the merger changed its name to Telefónica Brasil, S.A.

Following the share exchange, a partial contribution was made to Sao Paulo Telecommunicaçoes (SPT), leaving the direct stake in Telesp at 24.68%. All the aforementioned transactions were performed at the carrying amounts.

On June 27, 2011, Telefónica, S.A. subscribed a capital increase of 1,285 million Mexican pesos (76 million euros). In October 2011, several more capital increases were carried out, totaling 1,832 million Mexican pesos (100 million euros).

In late 2010, the Telefónica Group was awarded a mobile telephone license in Costa Rica. Until that date, the Group had no operations in that country. To operate under this license, on February 14, 2011 Telefónica, S.A. incorporated the company Azules y Platas, S.A., with 2 million US dollars. The Company made an additional contribution to equity of 6 million euros on February 15, 2011, as well as a capital increase of 170 million US dollars on June 26, 2011. The euros value of the three aforementioned capital increases is 127 million euros. On September 22, 2011 the change of name of this company, to Telefónica de Costa Rica, S.A., was formally entered in the pertinent mercantile registry.

On September 26, 2011, Telefónica, S.A. injected a further 80 million euros of equity into Casiopea Re, S.A.

In 2010, Telefónica entered into three equity swap contracts for Portugal Telecom, SGPS, S.A. shares with a number of financial institutions, subject to net settlement, which grant Telefónica the equivalent total return of the investment. In December 2011, the Company sold 1.9 million shares.

In October 2011, the Company reclassified the carrying amount of its stake in this company at that date to Available-for-sale financial assets. Consequently, since October 2011, changes in the market value of these shares have been reflected under equity (32 million euros, net of the tax effect, in 2011).

At each year end, the Company reviews its subsidiaries business plans and cash flows derived there from and, based on the value of each company, estimates whether to recognize an impairment of these investments. In 2011, a write-down of 1,606 million euros was recognized as a result of this review. This amount reflects the net effect of the following: (a) the reversal of the impairment loss recorded for Telefónica Europe, plc. (1,279 million euros), less 120 million euros for the effect of the net investment hedge; (b) the write-down of 2,085 million euros in Telefónica Móviles México, S.A. de C.V.; (c) the write-down of 629 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year.

In 2011, Telefónica, S.A. adjusted the cost of its investment in Banco Bilbao Vizcaya Argentaria, S.A. by 80 million euros, in order to bring the cost per share in line with the fair value. This adjustment was taken directly to the income statement, under Gain (loss) on available-for-sale financial assets recognized in the period , with no impact on the statement of recognized income and expenses.

Share price performance

The main European markets were severely affected by the performance of the debt markets in 2012. During the first half of the year, rising risk premiums of countries in Southern Europe drove the Ibex 35 index down to its lowest level since March 2003 on July 24, 2012, after the Spanish risk premium reached 627.7 points, situating the Spanish ten-year bond yield at 7.5%. Despite this, during the latter half of the year, decisions taken by the European Union and the statements of the Chairman of the European Central Bank (ECB) led to a gradual reduction in the risk premium and the equities markets rebounded, ending 2012 with gains across Europe: EStoxx-50 +13.8%; DAX +29.1%; CAC-40 +15.2%; FTSE-100 +5.8% and FTSEMIB: +7.8).

The Spanish ten-year bond yield closed 2012 at 5.2% (5.0% at year-end 2011), while the spread compared to the German bond was 388.7 basis points (317.0 basis points at year-end 2011). This was reflected in the performance of the Spanish stock market which, despite gains in the second half of the year (+37% from lows in July), posted losses for the third consecutive year. The Ibex-35 index contracted by 4.7% in 2012 affected by the euro zone crisis, the rising risk premium and doubts surrounding the health of the financial sector.

Against this backdrop, Telefónica shares dropped by 23.9% (10.19 euros per share at year-end 2012), having performed more poorly than the sector in Europe (-10.7%). Other European operators also suffered declining share prices during the year: KPN: -59.8%; France Telecom: -31.3%; Telecom Italia: -17.8%; PT: -15.8; Vodafone: -13.7%; Deutsche Telekom: -3.0%. The total return on Telefónica shares in 2012 was -17.8% (including the dividends distributed throughout 2012).

At the 2011 year end, Telefónica featured among the world s ten largest telecommunications company by market cap (46,375 million euros).

Daily trading volume in Telefónica shares on Spain s continuous market was 42.9 million shares in 2012 (56.4 million shares in 2011).

Research, development and innovation

Telefónica remains firmly committed to technological innovation as an essential tool for achieving competitive advantages, anticipating market trends and differentiating its products. By introducing new technologies and developing new products and business processes, we seek to become a more effective, efficient and customer-oriented Group.

Telefónica has developed an open innovation model for the management of technological innovation to boost the application of technical research in the development of new commercial products and services. Telefónica focuses on certain applied research and development (R&D) priorities that are aligned with its strategy. Open innovation initiatives driving this model include the creation of a venture capital fund and involvement in business collaboration forums, among others. The model also promotes the use of knowledge developed at technology centers, universities and start-ups, among other sources, and encourages innovation in conjunction with other agents (e.g. customers, universities, public administrations, suppliers, content providers and other companies), making them technological partners. Telefónica believes it cannot rely solely on acquired technology to differentiate its products from those of its competitors and to improve its market positioning. It is also important to encourage R&D initiatives in an effort to achieve this differentiation and make inroads in other innovation activities. The Group s R&D policy is geared towards

- developing new products and services in order to win market share;
- boosting customer loyalty;
- increasing revenue;
- enhancing innovation management;
- improving business practices;
- increasing the quality of infrastructure services to improve customer service and reduce costs;
- promoting global products;
- supporting open innovation; and
- creating value from the technology generated.

In 2012, the technological innovation projects undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of operations in new markets and technological leadership.

Technical innovation activities are a key part of Telefónica s strategy of creating value through latest-generation network communications and services.

In 2012, projects were undertaken to promote greater access to information technology, new services focused on new internet business models, advanced user interfaces, mobile television and other broadband services. These initiatives, among others, were undertaken based on our objective of rapidly identifying emerging technologies that could have a relevant impact on our businesses and pilot testing these technologies in new services, applications and platform prototypes.

Most of our R&D activities are carried out by Telefónica Investigación y Desarrollo, S.A.U., (Telefónica I+D), a wholly-owned subsidiary, which works mainly for the lines of business. In its operations, Telefónica I+D receives the assistance of other companies and universities. Telefónica I+D s mission is centered on enhancing the Company s competitive positioning by leveraging technological innovation and product development. Telefónica I+D undertakes experimental and applied research and new product development with the overriding goal of broadening the range of services offered and reducing operating costs.

Telefónica I+D s technological innovation activities focus on certain areas:

Telefónica I+D s work on new networks, primarily in collaboration with Telefónica s *Global Resources team.* These activities are related with new radio access technologies (LTE-Advanced); network virtualization technologies, in line with the trend in technology such as software defined networks (SDN); and network optimization and zero touch developments making networks more flexible and moldable and able to adapt dynamically to new digital consumer and service requirements.

R&D activities to develop new products and services are conducted as part of Telefónica Digital s strategy. Indeed, Telefónica I+D forms the foundations of Telefónica Digital s Product Development & Innovation Department. These activities include the following:

- Natural P2P communication of the future, using the Internet, Web 2.0 and smart phones.
- Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.
- Advanced solutions in emerging ITC businesses such as e-health, and remote patient support or monitoring.
- M2M (machine-to-machine) service management associated with energy efficiency and mobility.
- Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.)

Telefónica I+D s also boasts scientific work groups with a more medium- to long-term focus and aim to look into opportunities relating to new networks and services and solutions to the technological challenges that arise.

At December 31, 2012, Telefónica I+D had 667 employees (653 employees in 2011).

Total research and development costs amounted to 1,071 million euros in 2012. This figure represents an increase of 9% up to 983 million euros (797 million euros in 2010). Total R&D costs represent 1.7%, 1.6% and 1.3% of the Group s consolidated revenue, in 2012, 2011 and 2010 respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD). Using these and other guidelines, there are R&D costs that, due to the length of projects and/or accounting classifications, are not included in their entirety in the consolidated statement of financial position.

In 2012, Telefónica registered 87 patents (95 in 2011), 78 of which were registered with the Spanish Patent and Trademark Office and (OEPM for its initials in Spanish) and 9 with the United States Patent and Trademark Office (USPTO). Of the patents pending with the OEPM, 45 are Spanish (ES) applications, 29 European (EP) applications, and 4 international (PCT) applications.

Table of Contents

2012 Financial Statements

Financing

The main financing transactions undertaken by Telefónica S.A. in the bonds market in 2012 are as follows:

Issue date	Maturity date	Nominal amount (Millions of euros)	Issue currency	Coupon
2012/29/11	2022/29/11	1,165	EUR	4.184%

Telefónica S.A., has a fully and unconditionally guaranteed the following issues by Telefónica Emisiones, S.A.U. during 2012:

Issue date	Maturity date	Nominal amount (Millions of euros)	Issue currency	Coupon
2012/07/02	2017/07/02	120	EUR	4.750%
2012/21/02	2018/21/02	1,500	EUR	4.797%
2012/12/03	2020/12/03	700	GBP	5.597%
2012/30/03	2017/30/03	1,250	CZK	3.934%
2012/11/07	2018/11/07	10,000	JPY	4.250%
2012/19/09	2017/05/09	1,000	EUR	5.811%
2012/19/10	2020/20/01	1,200	EUR	4.710%
2012/14/12	2018/14/12	250	CHF	2.718%
2012/14/12	2022/14/12	150	CHF	3.450%

The main financing transactions undertaken by Telefónica, S.A. in the banking market in 2012 are as follows:

Descriptive name summary	Prevailing limit	Currency	Nominal amount (millions of euros)	Arrangement date	Maturity date
Bilateral loan	200	EUR	200	12/27/02	15/27/02
Syndicated loan Tranche D2 *	923	EUR	923	12/02/03	15/14/12

* Limit in Pounds sterling converted to euros at 2012/14/12 and available from 2012/14/12

Telefónica, S.A. has fully and unconditionally guaranteed the following financing arrangements of Europe, B.V. entered into during 2012:

Descriptive name summary	Prevailing limit	Currency	Nominal amount (millions of euros)	Arrangement date	Maturity date
Syndicated loan (Tranche D1)*	801	EUR	801	12/02/03	15/14/12
Syndicated loan (Tranche E1)	756	EUR		12/02/03	17/02/03
Syndicated loan (Tranche E2)***	1,469	GBP		12/02/03	17/02/03
Financing granted**	375	USD	284	12/05/01	22/31/01
Financing granted**	1,200	USD		12/28/08	23/31/10

* Limit in Pounds sterling converted to euros at 2012/14/12 and available from 2012/14/12
** These credit facilities have a repayment schedule
*** Available from 2013/13/12

Transactions with treasury shares

At December 31, 2012 and 2011, Telefónica, S.A. held the following treasury shares:

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (*)	%
Treasury shares at 12/12/31	47,847,809	10.57	10.19	488	1.05136%

		Euros per share			
	Number of shares	Acquisition price	Trading price	Market value (*)	%
Treasury shares at 11/12/31	84,209,363	15.68	13.39	1,127	1.84508%

(*) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2012 and 2011 is as follows:

	Number of shares
Treasury shares at 10/12/31	**55,188,046**
Acquisitions	55,979,952
Disposals	(24,058,446)
Delivery PSP Phase III	(2,900,189)
Treasury shares at 11/12/31	**84,209,363**
Acquisitions	126,489,372
Delivery GESP share plan	(2,071,606)
Disposals	(76,569,957)
Share redemption	(84,209,363)
Treasury shares at 12/12/31	**47,847,809**

Furthermore, at December 31, 2012 and 2011, one Telefónica, S.A. share is held by Telefónica Móviles Argentina, S.A.

The amount paid to acquire treasury shares in 2012 and 2011 was 1,346 million euros and 822 million euros, respectively.

On May 25, 2012, pursuant to the resolutions adopted in the General Shareholders Meeting of May 14, capital was reduced by redeeming 84,209,363 treasury shares, thereby reducing treasury shares by 1,321 million euros.

Treasury shares sold in 2012 and 2011 amounted to 801 million euros and 445 million euros, respectively. The main treasury share sales transactions during 2012 were as follows:

In November 2012, Telefónica submitted an offer to purchase and cancel the preference shares that it had indirectly issued in 2002 through its subsidiary Telefónica Finance USA, LLC totaling 2,000 million euros. The offer involved acquiring these shares at their par value, subject unconditionally and irrevocably to the simultaneous reinvestment in Telefónica, S.A. shares and the subscription of newly issued plain-vanilla bonds, in the following percentage:

a) 40% of the amount in treasury shares of Telefónica, S.A.

b) 60% of the amount shall be used to subscribe a bond issue with a face value of 600 euros, issued at par.

97% of the holders of the preference shares accepted the offer, and therefore 76,365,929 treasury shares with a carrying amount of 815 million euros (exchange value of 776 million euros) were handed over, which are included under Disposals in 2012.

In addition to these disposals, on July 27, 2012, 2,071,606 treasury shares were written off the balance sheet on delivery to Telefónica, S.A. employees when the first phase of the Global Employee Share Plan (the GESP) matured. In 2012, no shares have been awarded to Group executives when the fourth phase of the Performance Share Plan (the PSP) matured; therefore no disposals have been recognized for this item. In December 2012, the second phase of the GESP started, and 116,443 treasury shares were used to meet the demand for shares of employees that had joined this plan.

On June 30, 2011 and July 4, 2011, following the end of the third phase of the Performance Share Plan (PSP), a total of 2,446,104 treasury shares were added, corresponding to two financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. The gross number of shares linked to the plan amounted to 4,166,304 shares, with a net 2,900,189 shares finally awarded (33 million euros).

Expanding on the existing strategic alliance, on January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited (China Unicom) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica acquired through its subsidiary Telefónica Internacional, S.A.U. 282,063,000 shares of China Unicom from third parties for 358 million euros. In recognition of China Unicom s stake in Telefónica, approval was given at Telefónica s General Shareholders Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

At December 31, 2012, Telefónica held 178 million call options on treasury shares subject to physical settlement (190 million options on treasury shares at December 31, 2011).

The Company also has a derivative on Telefónica shares, to be settled by offset, which has increased from 26 million shares in 2011 to 28 million shares in 2012, and is recognized under Derivatives (financial assets, current) on the balance sheet (in 2011, the fair value of this derivative was negative and therefore it was recognized under Derivatives (financial liabilities, current).

Risks and uncertainties facing the Company

The Telefónica Group s business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position and results, are as follows:

Group-related risks

Country risk (investments in Latin America)

At December 31, 2012, approximately 48.9% of the Telefónica Group s revenue (approximately 49.6% of its assets) is generated by the Latin American segment (primarily in Brazil, Argentina, Venezuela, Chile and Peru); 78.3% of those assets are generated in countries classified as investment grade (Brazil, Chile, Peru, Colombia, Mexico, Uruguay and Panama) by some of the credit rating agencies. The Telefónica business is especially sensitive to any of the risks related to Latin America described in this section, particularly if they affect or arise in Brazil, which at December 31, 2012 accounted for 50.6% of assets and 44.6% of revenue from Latin American operations.

The Group s investments and operations in Latin America could be affected by a series of risks related to economic, political and social factors in these countries, collectively denominated country risk, including risks related to the following:

- government regulation or administrative polices may change unexpectedly, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approval) which could negatively affect the Group s interests in such countries;

- the effects of inflation, currency depreciation or currency restrictions and other restraints on transfer of funds may be imposed. For example, in Venezuela, the official US Dollar to Bolivar fuerte exchange rate is established by the Central Bank of Venezuela and the Minister of Finance. Additionally, the acquisition of foreign currencies by Venezuelan companies to pay foreign debt or dividends is subject to the pre-authorization of the relevant Venezuelan authorities;

- governments may expropriate or nationalize assets or increase their participation in the economy and companies; and

- economic downturns, political instability and civil disturbances may negatively affect the Telefónica Group s operations in such countries.

Foreign currency and interest rate risk

The Telefónica Group s business is exposed to various types of market risks, above all the impact of changes in interest rates or foreign currency exchange rates.

At December 31, 2012, 23% of the Group s net debt was at floating rates, while 20% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2012: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 96 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, dollar and the pound sterling, in order to avoid negative rates, would lead to a reduction in financial expenses of 36 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

As for the impact on the income statement, specifically exchange gains and losses in the financial result at December 31, 2012, the impact of a 10% increase or decrease in the exchange rate would be 159 million euros (assuming a constant currency position with an impact on profit or loss at that date including derivative instruments arranged and that Latin American currencies would fall against the US dollar and the rest of the currencies against the euro by 10%).

The Telefónica Group uses a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. Furthermore, the Group s risk management strategies may not achieve the desired effect, which could adversely affect the Group s business, financial condition, results of operations and cash flows.

Dependence on external sources of financing

The performance, expansion and improvement of networks, the development and distribution of the Telefónica Group s services and products, as well as the development and implementation of new technologies or the renewal of licenses require a substantial amount of financing.

The performance of financial markets in terms of liquidity, cost of credit, access and volatility, continues to be overshadowed by persisting uncertainty regarding certain factors such as the pace of economic recovery, the health of the international banking system or the concerns regarding the burgeoning deficits of some European countries. The worsening international financial market conditions caused by some of these factors could make it more difficult and more expensive to refinance existing financial debt (at December 31, 2012, gross maturities in 2013, including the net position in derivative financial instruments, certain current payables and expected early redemptions amounted to around 10,074 million euros, or 9,574 million euros should Telefónica elect not to exercise expected early redemptions, and in 2014 to 7,850 million euros) or arrange new debt if necessary, and more difficult and costly to raise funds from our shareholders.

Furthermore, obtaining financing on the international capital markets could also be restricted (in terms of access and cost) if Telefónica s credit ratings are revised downwards, either due to lower solvency or operating performance, or as a result of a downgrade in the rating for Spanish sovereign risk by rating agencies. Any of these situations could have a negative impact on our ability to honor our debts.

Moreover, market conditions could make it harder to renew existing undrawn bilateral credit lines, 18% of which, at December 31, 2012, initially mature prior to December 31, 2013.

Risks related to the Company s industry

Current global economic situation

The Telefónica Group s business is impacted by general economic conditions in each of the countries in which it operates. The uncertainty about whether economic recovery will continue may negatively affect the level of demand from existing and prospective customers, as customers may no longer deem critical the services offered by the Group. The main macroeconomic factors that could have an adverse impact on consumption and, accordingly, demand for our services and the Telefónica Group s results include the dearth of credit as banks adjust their balance sheets, trends in the labor market, further erosion of consumer confidence, with an immediate increase in saving rates, or needs for greater fiscal adjustment, which would undermine household income levels. This risk is higher in Europe, but less relevant in other countries where the Telefónica Group operates.

Similarly, the sovereign debt crisis in certain euro-area countries and rating downgrades in some of these countries should be taken into account. Any further deterioration in sovereign debt markets or greater restrictions on credit in the banking sector could have an adverse impact on Telefónica s ability to raise financing and/or obtain liquidity. This could have a negative effect on the Group s business, financial condition, results of operations or cash flows. In addition, there could be other possible follow-on effects from the economic crisis on the Group s business, including insolvency of key customers or suppliers.

Lastly, in Latin America, the exchange rate risk in Venezuela (as reflected by the recent currency devaluation in February 2013) and Argentina (with a constant devaluation of the Argentinean peso against U.S. dollar) exists in relation to the negative impact any unexpected weakening in their currencies could have on cash flows from these countries. On February 8, 2013, the Venezuelan bolivar fuerte was devalued from 4.3 bolivar fuertes per U.S. dollar to 6.3 bolivar fuertes per U.S. dollar. The decision of the Venezuelan government affects the estimates made by the Group of the net asset value of the foreign currency position related to investments in Venezuela, which translates to an approximate pre-tax loss of 438 million euros on the 2012 financial statements.

Highly regulated markets

As a multinational telecommunications company that operates in regulated markets, the Telefónica Group is subject to different laws and regulations in each of the jurisdictions in which it provides services and in which supranational regulators such as the European Union and national, state, regional and local authorities intervene to varying degrees and as appropriate. This regulation is strict in the countries in which the Company holds a significant market power position.

In Europe, wholesale mobile network termination rates came down in 2011. There were considerable reductions in many of the countries where the Group operates, notably in the UK (with a final reduction scheduled for 2015 and a decrease in prices of over 83% compared to the end of 2010) and Germany (cuts of over 50% since December 2010). In Spain, the schedule for reducing mobile call termination rates came into play on April 16, 2012, and the target price (1.09 euros) will be attained in July 2013, with a decrease of approximately 75% in wholesale prices. Other countries where rates will fall as from 2012 are the Czech Republic (slightly more than 49%), Ireland (approximately 72%) and Slovakia (approximately 58%).

Other services with regulated prices in Europe include call roaming, SMS and data services. The European Parliament and Council has approved the new Roaming III regulation which replaces all previous regulations. The objective of this Regulation is to set maximum prices for voice and SMS retail and wholesale services between July 2012 and July 2014, which will then be progressively reduced. It also regulates retail and wholesale data roaming charges for the first time.

Additionally, according to Roaming III, from July 2014, mobile operators would be forced to separate the sale of roaming services from their domestic services. This would allow users to choose a different operator for calls made in other Member States. Lastly, in relation to net neutrality, the new European regulatory framework establishes as a general principle the importance of ensuring European citizens have free internet access. Nevertheless, regulators could also adopt at any time measures or additional requirements to reduce roaming prices and fixed and/or mobile termination rates, and force Telefónica to provide third-party access to its networks.

Moreover, in Latin America there is tendency to review and reduce mobile network termination rates. For instance, reductions of 61% and 60% have been approved in Mexico and Chile, respectively. In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment regulation, which entails a gradual reduction of these rates through to 2014 by applying a CPI-factor, which results in a reduction of approximately 29% in 2012-2014. The absolute decrease in public rates must be passed on to mobile interconnection rates (VU-M). In addition, there is a trend towards reductions in termination rates in Peru, Venezuela and Colombia.

The new regulatory principles established in Europe s common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operated during 2011 and 2012 could result in increased regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators, in specific cases and under exceptional conditions, establishing the functional separation between the wholesale and retail businesses of operators with significant market power and vertically integrated operators, whereby they would be required to offer equal wholesale terms to third-party operators that acquire these products.

The recommendation on the application of the European regulatory policy to next-generation broadband networks drawn up by the European Commission (EC) could also play a key role in the incentives for operators to invest in net fixed broadband networks in the short-term and medium-term, thus affecting the outlook for the business and competition in this market segment. Nonetheless, the EC is currently drafting respective recommendations on cost accounting and non-discrimination, and it is expected that these recommendations, which will affect the earlier recommendation, will be approved in mid-2013. According to statements by Commissioner Kroes, initial evaluations are that the Commission could make the regulation for new generation networks more flexible in exchange for stricter measures on new operators concerning non-discrimination.

Meanwhile, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to economic fines for serious breaches and, ultimately, revocation or failure to renew these licenses, authorizations or concessions or the granting of new licenses to competitors for the provisions of services in a specific market.

The Telefónica Group pursues their renewal to the extent provided by the contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases it must satisfy certain obligations, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in fines or even revocation or forfeiture of the license, authorization or concession.

Additionally, the Telefónica Group could be affected by regulatory actions carried out by antitrust of competition authorities. These authorizations could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could results in economic and/or reputational loss for the Group, in addition to a loss of market share and/or in harm to the future growth of certain businesses.

Highly competitive markets and markets subject to constant technological development

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, it is subject to the effects of actions by competitors in these markets and its ability to anticipate and adapt to constant technological changes taking place in the industry.

To compete effectively, the Telefónica Group needs to successfully market its products and services and respond to both commercial actions by competitors and other competitive factors affecting these markets, anticipating and adapting promptly to technological changes, changes in consumer preferences and general economic, political and social conditions. Failure to do so appropriately could have an adverse impact on the Group s financial condition, results of operations and cash flows.

New products and technologies arise constantly, while the development of existing products and technologies can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, and which may result in the decrease of the Group s revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile internet and connectivity services that are being launched. Research and development costs amounted to 1,071 million euros and 983 million euros in 2012 and 2011, respectively, representing 1.7% and 1.6% of the Group s consolidated revenue, respectively.

One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, e.g. internet speed of up to 100mb or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. As things stand today, scant demand for the capabilities offered by these new networks to end users could make it difficult to quantify the return on investment and justify the high investment.

In addition, many of the aforementioned works directed to network upgrade and to offer new products or services are not entirely under the Telefónica Group s control and could be constrained by applicable regulation.

Limitations on spectrum capacity could be costly and curtail growth.

Telefónica s mobile operations in a number of countries may rely on the availability of spectrum. The Company s failure to obtain sufficient or appropriate spectrum capacity or its capacity to assume the related costs, could have an adverse impact on the quality on the launching and provision of new services and on the Company s ability to maintain the quality of existing services, which may adversely affect the Group s financial condition, results of operations and cash flows

In 2012, Telefónica Ireland invested 127 million euros to obtain spectrum in the 800, 900 and 1800 MHz bands. On February 20, 2013, Telefónica UK was granted two blocks of 10 MHz in the 800 MHz spectrum band for the rollout of a nationwide 4G network, total investment was of approximately 645 million euros. Meanwhile, in 2012, an investment was made in spectrum capacity in Nicaragua amounting to 5 million euros. In Brazil, Vivo was awarded a block of band with X of 2500 MHz (20+20 MHz), including the 450 MHz band in certain states in 2012. In Venezuela, in August 2012, a concession agreement was signed between Telefónica Venezuela and the regulator for the additional 20 MHz in the 1900 MHz frequency that had been granted to this company. Also in August 2012, Telefónica Móviles Chile, S.A. was awarded radiofrequencies for 4G technology. As regards new spectrum allocations in the countries where the Telefónica Group operates, in 2013 we are expecting auctions to take place in Slovakia, Colombia and Uruguay.

Supplier failures

As a mobile and fixed telephony operator and provider of telecommunications services and products, the Telefónica Group, like other companies in the industry, depends upon a small number of major suppliers for essential products and services, mainly network infrastructure and mobile handsets. Telefónica Group depends on 13 handset suppliers and five network infrastructure suppliers, which together accounted for 80% of orders in 2012. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group s ability to satisfy its license terms and requirements or have an adverse impact on the Group s business, financial condition, results of operations and cash flows.

Risks associated with unforeseen network interruptions

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group s service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group s reputation.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover this type of incidents and risks, these policies may not be sufficient to cover all possible monetary losses, although the claims and loss in revenue caused by service interruptions to date have been covered by these policies.

Electromagnetic radio emissions and possible health risks

Currently, there is significant public concern regarding alleged potential effects of electromagnetic fields, emitted by mobile telephones and base stations, on human health. This social concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service and affected the deployment criteria of new networks.

In May 2011, the specialized cancer research body of the World Health Organization (IARC) classified the electromagnetic fields in mobile telephony as possibly carcinogenic, a classification which also includes products such as coffee and pickled foods. The World Health Organization subsequently indicated, in its fact sheet no. 193 published in June 2011, that to date it cannot be confirmed that the use of a mobile telephone has adverse effects on health.

The most recent official study (to the best of our knowledge), published in 2012 by Advisory Group on Non-ionising Radiation (AGNIR), concludes that there are not convincing evidences showing that mobile phone technologies cause adverse effects in the health of individuals. It cannot be certain that future reports and medical studies establish a link between the electromagnetic signals or emissions of radio frequencies and health problems.

Irrespective of the scientific evidence that may be obtained and even though the Telefónica Group has considered these risks and has an action plan for the various countries in which it provides services to ensure compliance with codes of good practice and relevant regulations, this concern, may affect the capacity to capture or retain customers, discourage the use of mobile telephones, or lead to legal costs and other expenses.

Society s worries about radiofrequency emissions could reduce the use of mobile telephones, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located and how they operate, and the use of our mobile devices, telephones and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network. Furthermore, if any relevant authorities request that the thresholds of exposure to electromagnetic fields be reduced, the Company may have to invest in reconstructing its network to comply with these guidelines.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect that may also arise in the future may adversely affect the Group s business, financial condition, results of operations and cash flows.

Risk of asset impairment

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets.

Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group s operations. In this respect, the Telefónica Group has experienced impairment losses on certain of its investments, affecting the results of the year in which they were made. In 2012, an impairment loss was recognized on the stake in Telco, S.p.A. which, coupled with the impact of the recovery of all the operational synergies considered at the time of the investment and the profit contribution for the year, resulted in a negative impact of 1,277 million euros. In 2012, an impairment loss in goodwill was recognized amounting to 414 million euros for Telefónica operations in Ireland which, combined with the write-off of the intangible asset associated with the customer portfolio allocated to this market, resulted in a negative impact of 527 million euros.

Risks associated with internet

Our internet access and hosting services may involve us in civil liability for illegal or illicit use of the internet. In addition, Telefónica, like all telecommunications services providers, may be held liable for the loss, release or inappropriate modification of the customer data stored on its services or carried by its networks

In most countries in which Telefónica operates, the provision of its internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as. blocking access to a website) as part of the struggle against some illegal or illicit uses of the internet, notably in Europe.

Other risks

Litigation and other legal proceedings

Telefónica and Telefónica Group companies are party to lawsuits and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group s business, financial condition, results of operations and cash flows.

Trend evolution

Telefónica is an integrated diversified telecommunications group that offers a wide range of services, mainly in Europe and Latin America. Its core business is the provision of fixed and mobile telephony, broadband, internet, data, pay TV and value added services, among others. The Group s operations in 25 countries, managed through a regional organization geared towards certain businesses in global units, enable it to leverage the strong local positioning, as well as the advantages afforded by the scale, two features that have been reinforced by the opportunities arising from the Group s holdings in and strategic alliances with China Unicom and Telecom Italia.

As a multinational telecommunications company that operates in regulated markets, Telefónica is subject to different laws and regulations in each of the jurisdictions in which it provides services. Telefónica expects the regulatory landscape to continue to change in Europe as a consequence of the revised regulations resulting from the implementation of the review of the common regulatory framework currently in place in the European Union. In addition, Telefónica may also face pressure from regulatory initiatives in some European countries regarding tariffs, the reform of rights of spectrum use and allocation, issues related to the quality of service, and the regulatory treatment of new broadband infrastructure deployments.

Telefónica faces intense competition in the vast majority of the markets it operates in, and is therefore subject to the effects of actions taken by its competitors. The intensity of the competition may deepen, which could have an impact on tariff structures, consumption, market share and commercial activity and negatively affect the number of customers, revenues and profitability.

However, Telefónica believes that it is in a strong competitive position in most of the markets where it operates, which it expects to help enable it to continue taking advantage of the growth opportunities that arise in these markets, such as by boosting both fixed and mobile broadband services and by furthering the development of services beyond connectivity, information technology services and related businesses. In this respect, Telefónica seeks to lead the industry by anticipating trends in the new digital environment.

Telefónica embarked on a restructuring in September 2011 with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances. This new organization gave rise to two cross-cutting areas, Telefónica Digital and Telefónica Global Resources, in addition to the Telefónica Europe and Telefónica Latin America business segments. This structure should bolster Telefónica s place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its global customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica s transformation into a fully global company. Telefónica Europe s and Telefónica Latin America s objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation.

In Europe, customers remain at the core of the Group s strategy and management priorities in the region in order to provide a high level of customer satisfaction with our services. With the objective of offering our customers the best value, we aim to boost the mobile broadband services, adding new products and services to our current services. In such a competitive market such as presently prevails, we will dedicate our efforts on reinforcing our market positioning. Another objective in coming years is to improve operating efficiency, for which we are rolling out several local and regional initiatives, such as network sharing agreements, with the support of Telefónica Global Resources.

In Telefónica Europe, in Spain, a transformation strategy was kicked off half way through 2011 to improve the Company s competitive position in the market and boost the efficiency of its business model. This strategy has led to major changes in the sales and operating model, such as improvements to the value proposition and service quality by the end of 2011 through the launch of a new tariff portfolio, the elimination of subsidies to attract customers in March 2012, and the launch of Movistar Fusión (convergent offer meeting all home communication needs). Telefónica will continue to focus on service quality, improving the effectiveness of campaigns in the sales channel, and further increasing network quality and characteristics (by developing fiber optics). The aim of this strategy is to boost customer satisfaction by offering them a portfolio of products and services that best meets their communication needs.

In Latin America, Telefónica s strategy is based on a regional model that captures growth and efficiency of scale without losing sight of the local management of the client. Telefónica expects the mobile business to continue to play a fundamental role as an engine of regional growth. That is why we will continue to improve the capacity and coverage of our networks, adapting our distribution channel to enhance the quality of our offerings both in voice and data in order to keep and attract high-value customers. Regarding the fixed telephony business, we will encourage the increase of broadband speed and expand the supply of bundled services. Meanwhile, we will further advance efficiency, in operational and commercial terms, and attempt to achieve further synergies by implementing global, regional and local projects.

In summary, in the context of intense competition and regulatory pressure on pricing, Telefónica aims to continue strengthening its business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while focusing even more on the client and staying ahead of trends in the new digital world.

Events after the reporting period

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

On January 22, 2013, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note (EMTN) registered with the Financial Services Authority (FSA) in London and updated on June 12, 2012, issued bonds for an aggregate amount of 1,500 million euros maturing on January 23, 2023. These bonds are guaranteed by Telefónica, S.A.

In January 2013, Telefónica made repayments for an aggregate amount of 1,830 million euros of the syndicated loan signed on July 28, 2010.

On February 4, 2013 Telefónica Emisiones, S.A.U. redeemed bonds that were issued on July 2, 2007, for an aggregate amount of 750 million US dollars and 850 million US dollars (approximately 1,213 million euros). These bonds were guaranteed by Telefónica, S.A.

On February 14, 2013 Telefónica Emisiones, S.A.U. redeemed bonds that were issued on October 31, 2004, for an aggregate amount of 1,500 million US dollars. These bonds were guaranteed by Telefónica, S.A.

On February 21, 2013, Telefónica, S.A. arranged financing for the purchase of capital goods worth 206 million euros maturing in 2016.

On February 22, 2013, Telefónica, S.A. arranged financing for the purchase of capital goods worth 1,001 million US dollars (approximately 759 million euros). At the date of authorization for issue of these financial statements, no amount of this financing had been drawn down

On February 22, 2013, Telefónica, S.A. arranging refinancing of 1,400 million euros for Tranche A2 (initially for 2,000 million euros with expected maturity on July 28, 2014) of the 8,000 million euros syndicated loan arranged on July 28, 2010. This refinancing entails two tranches: a syndicated loan of 700 million euros maturing in 2017 and a syndicated loan of 700 million euros maturing in 2018.

Table of Contents

Annual Corporate Governance Report

A. Ownership structure

A.1 Complete the following table on the company s share capital:

Date of last modification	Share capital ( )	Number of shares	Number of voting rights
06-08-2012	4,551,024,586.00	4,551,024,586	4,551,024,586

Indicate whether different types of shares exist with different associated rights:

No

A.2 List the direct and indirect holders of significant ownership interests in your organization at year-end, excluding directors:

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights (*)	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	261,514,757	283,680	5.753
Caja de Ahorros y Pensiones de Barcelona, la Caixa	0	254,697,815	5.596
Blackrock, Inc.	0	177,257,649	3.895

Name or corporate name of indirect shareholder	Through: name or corporate name of direct shareholder	Number of direct voting rights	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Broker Correduria de Seguros y Reaseguros, S.A.	7,856	0.000
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Seguros, S.A. de Seguros y Reaseguros	268,324	0.006
Banco Bilbao Vizcaya Argentaria, S.A.	UNNIM GESFONS SGIIC,S.A.	7,500	0.000
Caja de Ahorros y Pensiones de Barcelona, la Caixa	Caixabank, S.A.	253,970,964	5.581
Caja de Ahorros y Pensiones de Barcelona, la Caixa	Compañía Andaluza de Rentas e Inversiones, S.A.	682,500	0.015
Caja de Ahorros y Pensiones de Barcelona, la Caixa	VidaCaixa, S.A. de Seguros y Reaseguros	44,351	0.001
Blackrock, Inc.	Blackrock Investment Management (UK)	177,257,649	3.895

Indicate the most significant movements in the shareholder structure during the year.

A.3 Complete the following tables on company directors holding voting rights through company shares.

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights (*)	% of total voting rights
Mr. César Alierta Izuel	4,339,383	80,053	0.097
Mr. Isidro Fainé Casas	508,875	0	0.011
Mr. José María Abril Pérez	94,586	108,386	0.004
Mr. Julio Linares López	418,946	1,887	0.009
Mr. José María Álvarez-Pallete López	325,734	0	0.007
Mr. Alfonso Ferrari Herrero	586,352	19,499	0.013
Mr. Antonio Massanell Lavilla	2,346	0	0.000
Mr. Carlos Colomer Casellas	17,102	95,448	0.002
Mr. Francisco Javier de Paz Mancho	55,273	0	0.001
Mr. Gonzalo Hinojosa Fernández de Angulo	87,725	447,474	0.012
Mr. Ignacio Moreno Martínez	12,713	0	0.000
Mr. José Fernando de Almansa Moreno-Barreda	19,449	0	0.000
Mr. Luiz Fernando Furlán	34,035	0	0.001
Ms. María Eva Castillo Sanz	97,089	0	0.002
Mr. Pablo Isla Álvarez de Tejera	8,816	0	0.000
Mr. Peter Erskine	71,081	0	0.002
Mr. Santiago Fernández Valbuena	505,949	50,000	0.012
% of total voting rights held by the Board of Directors			0.176

Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct share options	Number of indirect share options	Equivalent number of shares	% of total voting rights
Mr. César Alierta Izuel	170,897	0	170,897	0.004
Mr. César Alierta Izuel (2)	100,000	0	10,000,000	0.002
Mr. César Alierta Izuel (3)	574,334	0	897,397	0.013
Mr. Julio Linares López	128,173	0	128,173	0.003
Mr. Julio Linares López (2)	163,828	0	255,983	0.004
Mr. José María Álvarez-Pallete López	77,680	0	77,680	0.002
Mr. José María Álvarez-Pallete López (2)	267,650	0	418,204	0.006
Ms. María Eva Castillo Sanz	95,864	0	149,787	0.002
Mr. Santiago Fernández Valbuena	77,680	0	77,680	0.002
Mr. Santiago Fernández Valbuena (2)	182,742	0	285,536	0.004

A.4 Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are insignificant or arise from ordinary trading or exchange activities.

A.5 Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are insignificant or arise from ordinary trading or exchange activities.

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding with Telefónica Móviles España, S.A.U. in Mobipay España, S.A.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding of Banco Bilbao Vizcaya Argentaria, S.A. or any of the Group Companies with Telefónica, S.A., in Telefónica Factoring, S.A., Telefónica Factoring Perú, S.A.A., Telefónica Factoring Colombia, S.A., Telefónica Factoring Brasil, S.A., Telefónica Factoring México, S.A. de C.V. SOFOM, ENR, and Telefónica Factoring Chile, S.A.
Caja de Ahorros y pensiones de Barcelona, La Caixa	Corporate	Joint shareholding of Caixabank, S.A. with Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. or any of the Group Companies in Telefónica Factoring, S.A., Telefónica Factoring Perú, S.A.A., Telefónica Factoring Colombia, S.A., Telefónica Factoring Brasil, S.A., Telefónica Factoring México, S.A. de C.V. SOFOM, ENR, and Telefónica Factoring Chile, S.A.

A.6 Indicate whether any shareholders agreements have been notified to the company pursuant to article 112 of the Securities Market Act (Ley del Mercado de Valores). Provide a brief description and list the shareholders bound by the agreement, as applicable.

Yes

% of share capital affected	0.87

Brief description of the agreement:

In accordance with the provisions of article 112, section 2 of the Securities Market Act 24/1988, of July 28 (currently replaced by article 531 section 1 of the revised text of the Corporate Enterprises Act approved by Royal Legislative decree 1/2010, of 2 July), on 22 October 2009, the Company notified the Spanish Securities Market Commission in writing that on September 6, 2009 it had entered into a mutual share exchange agreement between Telefónica and China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per article 518 of the Corporate Enterprises Act. By virtue of these clauses, Telefónica, while the strategic alliance agreement is in force, is bound not to offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited, at the moment. In addition, China Unicom (Hong Kong) Limited, undertook for a period of one year not to sell, use or transfer, directly or indirectly, its share in Telefónica s voting share capital (excluding intragroup transfers). This undertaking was deprived of effect as with the aforementioned period of one year having expired.

At the same time, both parties also assumed similar obligations as the ones refered above with respect to the share capital of China Unicom (Hong Kong) Limited.

This mutual share exchange agreement, which includes the shareholder agreement, was filed in the Madrid Mercantile Registry on November 24, 2009.

Parties to the shareholders agreement
China Unicom (Hong Kong) Limited
Telefónica, S.A.

A.7 Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable.

No

Expressly indicate any amendments to or termination of such agreements or concerted actions that could have taken place during the year.

On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited (China Unicom) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica agreed to acquire through its subsidiary Telefónica Internacional, S.A.U. a number of China Unicom shares to the value of 500 million US dollars from third parties, within nine months from the agreement date. Additionally in recognition of China Unicom s stake in Telefónica, the latter commits to proposing the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company s Bylaws. Executing the stated before, the General Shareholders Meeting held on May 18, 2011 duly approved the appointment of China Unicom s nominee, Mr. Chang Xiaobing, as member of the Board of Directors.

China Unicom completed the acquisition of Telefónica shares on January 28, 2011, giving it ownership of 1.37% of the Company s capital.

One the other hand, the Telefónica Group purchased China Unicom shares during 2011 to the amount of 358 million euros. At December 31, 2011, the Telefónica Group held a 9.57% stake in the company.

On July 10, 2012, Telefónica, S.A. through its wholly-owned subsidiary Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited, through a wholly-owned subsidiary, signed an agreement for the purchase by the latter of 1,073,777,121 shares in China Unicom (Hong Kong) Limited owned by Telefónica, equivalent to 4.56% of total capital in that company.

After securing the regulatory authorizations requisite, on July 30, 2012 the sales transaction was completed.

Subsequent to the transaction, bothTelefónica and China Unicom remain firmly committed to their strategic partnership.

Telefónica has agreed not to sell the shares it holds directly and indirectly in China Unicom for a period of 12 months as from the date of the agreement.

Telefónica will also continue to enjoy representation on China Unicom s board of directors, while Telefónica s Board of Directors will continue to include a representative of China Unicom.

A.7 Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with article 4 of the Spanish Securities Market Act. If so, identify.

No

A.8 Complete the following tables on the company s treasury shares.

At the close of the financial year:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
47,847,809	1	1.051

(*) Through:

Name or corporate name of direct shareholder	Number of shares held directly
Telefónica Móviles Argentina, S.A.	1
Total	**1**

Give details of any significant changes during the year, in accordance with Royal Decree 1362/2007.

Date of notification	Total number of direct shares acquired	Total number of indirect shares acquired	% of total share capital
14/02/2012	46,947,192	15,177	1.021
21/05/2012	49,627,388	0	1.087
30/10/2012	47,640,860	0	1.047

Gain/(loss) on treasury shares sold during the year (thousands of euros)	-39,582

A.9 Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting authorizing the Board of Directors to purchase and/or transfer the treasury shares.

At Telefónica s Ordinary General Shareholders Meeting held on June 2, 2010, the shareholders resolved to renew the authorization granted at the GSM of June 23, 2009, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

To authorize, pursuant to the provisions of Section 75 et seq. of the Spanish Companies Act [Ley de Sociedades Anónimas, or LSA for its initials in Spanish], the derivative acquisition by Telefónica, S.A. either directly or through any of the subsidiaries of which it is the controlling company at any time and as many times as it deems appropriate, of its own fully- paid shares through purchase and sale, exchange or any other legal transaction.

The minimum price or consideration for the acquisition shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or consideration for the acquisition shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders Meeting and is expressly subject to the limitation that the par value of the Company s own shares acquired pursuant to this authorization added to those already held by Telefónica, S.A. and any of its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company s own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company s shares.

To authorize the Board of Directors, as broadly as possible, to exercise the authorization granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

To deprive of effect, to the extent of the unused amount, the authorization granted under Item IV on the Agenda by the Ordinary General Shareholders Meeting of the Company on June 23, 2009

A.10 Indicate, as applicable, any restrictions imposed by Law or the company s bylaws on exercising voting rights, as well as any legal restrictions on the acquisition or transfer of ownership interests in the share capital.

Indicate whether there are any legal restrictions on exercising voting rights:

No

Maximum percentage of voting rights a shareholder can exercise in accordance with legal restrictions	0

Indicate whether there are any restrictions included in the bylaws on exercising voting rights.

Yes

Maximum percentage of voting rights a shareholder can exercise in accordance with the company s bylaws	10.000

Description of restrictions on the exercise of voting rights, under law or the company s bylaws

According to Article 21 of the Company s Bylaws, no shareholder can exercise votes in respect of more than 10 per cent of the total shares with voting rights outstanding at any time, irrespective of the number of shares they may own This restriction on the maximum number of votes that each shareholder can cast refers solely to shares owned by the shareholder concerned and cast on their own behalf. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 per cent voting ceiling.

The 10 per cent limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

Bbesides, in relation to the above and in accordance with the provisions of article 527 of the Corporate Enterprises Act, any clauses in the bylaws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

Indicate if there are any legal restrictions on the acquisition or transfer of share capital.

No

Table of Contents

A.11 Indicate whether the General Shareholders Meeting has agreed to take neutralization measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.

No

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted.

B. Company management structure

B.1 Board of Directors

B.1.1 List the maximum and minimum number of directors as set out in the bylaws.

Maximum number of directors	20
Minimum number of directors	5

B.1.2 Complete the following table with board members details:

Name or corporate name of director	Representative	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. César Alierta Izuel		Chairman	01/29/1997	05/14/2012	Vote at General Shareholders Meeting
Mr. Isidro Fainé Casas		Vice Chairman	01/26/1994	05/18/2011	Vote at General Shareholders Meeting
Mr. José María Abril Pérez		Vice Chairman	07/25/2007	04/22/2008	Vote at General Shareholders Meeting
Mr. Julio Linares López		Vice Chairman	12/21/2005	05/18/2011	Vote at General Shareholders Meeting
Mr. José María Álvarez-Pallete López		Chief Executive Officer	07/26/2006	05/14/2012	Vote at General Shareholders Meeting
Mr. Alfonso Ferrari Herrero		Director	03/28/2001	05/18/2011	Vote at General Shareholders Meeting
Mr. Antonio Massanell Lavilla		Director	04/21/1995	05/18/2011	Vote at General Shareholders Meeting
Mr. Carlos Colomer Casellas		Director	03/28/2001	05/18/2011	Vote at General Shareholders Meeting
Mr. Chang Xiaobing		Director	05/18/2011	05/18/2011	Vote at General Shareholders Meeting
Mr. Francisco Javier de Paz Mancho		Director	12/19/2007	04/22/2008	Vote at General Shareholders Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo		Director	04/12/2002	05/14/2012	Vote at General Shareholders Meeting
Mr. Ignacio Moreno Martínez		Director	12/14/2011	05/14/2012	Vote at General

				Shareholders Meeting
Mr. José Fernando de Almansa Moreno-Barreda	Director	02/26/2003	04/22/2008	Vote at General Shareholders Meeting
Mr. Luiz Fernando Furlán	Director	01/23/2008	04/22/2008	Vote at General Shareholders Meeting
Ms. María Eva Castillo Sanz	Director	01/23/2008	04/22/2008	Vote at General Shareholders Meeting
Mr. Pablo Isla Álvarez de Tejera	Director	04/12/2002	05/14/2012	Vote at General Shareholders Meeting
Mr. Peter Erskine	Director	01/25/2006	05/18/2011	Vote at General Shareholders Meeting
Mr. Santiago Fernández Valbuena	Director	09/17/2012	09/17/2012	Cooption
Total number of directors				18

Indicate any board members who left during the reporting period.

Name or corporate name of director	**Status of the director at the time**	**Leaving date**
Mr. David Arculus	Independent	09/17/2012

Telefónica, S.A. 137

B.1.3 Complete the following tables on board members and their respective categories:

EXECUTIVE DIRECTORS

Name or corporate name of director	Committee proposing appointment	Post held in the company
Mr. César Alierta Izuel	Nominating, Compensation and Corporate Governance Committee	Executive Chairman
Mr. José María Álvarez-Pallete López	Nominating, Compensation and Corporate Governance Committee	Chief Operating Officer (C.O.O.)
Ms. María Eva Castillo Sanz	Nominating, Compensation and Corporate Governance Committee	Chairwoman Telefónica Europe
Mr. Santiago Fernández Valbuena	Nominating, Compensation and Corporate Governance Committee	Chairman Telefónica Latin America
Total number of executive directors		4
% of the board		22.222

EXTERNAL PROPRIETARY DIRECTORS

Name or corporate name of director	Committee proposing appointment	Name or corporate name of significant shareholder represented or proposing appointment
Mr. Isidro Fainé Casas	Nominating, Compensation and Corporate Governance Committee	Caja de Ahorros y Pensiones de Barcelona, la Caixa
Mr. José María Abril Pérez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Antonio Massanell Lavilla	Nominating, Compensation and Corporate Governance Committee	Caja de Ahorros y Pensiones de Barcelona, la Caixa
Mr. Chang Xiaobing	Nominating, Compensation and Corporate Governance Committee	China Unicom (Hong Kong) Limited
Mr. Ignacio Moreno Martínez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Total number of proprietary directors		5
% of the board		27.778

INDEPENDENT EXTERNAL DIRECTORS

Name or corporate name of director	Profile
Mr. Alfonso Ferrari Herrero	Industrial Engineer. Formerly Executive Chairman of Beta Capital, S.A. and senior manager at Banco Urquijo.
Mr. Carlos Colomer Casellas	Graduate in Economics. Chairman of the Colomer Group.
Mr. Francisco Javier de Paz Mancho	Graduate in Information and Advertising. Law Studies. IESE Business Management

	Program. Formerly Chairman of the State-owned company MERCASA.
Mr. Gonzalo Hinojosa Fernández de Angulo	Industrial Engineer. Formerly Chairman and CEO of Cortefiel Group.
Mr. Luiz Fernando Furlán	Degrees in chemical engineering and business administration, specializing in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.
Mr. Pablo Isla Álvarez de Tejera	Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A.
Mr. Peter Erskine	Psychology Graduate. Was General manager of Telefónica Europe until 2007. Currently Chairman of Ladbrokes, Plc.
Total number of independent directors	7
% of the board	38.889

OTHER EXTERNAL DIRECTORS

Name or corporate name of director	Committee proposing appointment
Mr. Julio Linares López	Nominating, Compensation and Corporate Governance Committee
Mr. José Fernando de Almansa Moreno-Barreda	Nominating, Compensation and Corporate Governance Committee
Total number of other external directors	2
% of the board	11.111

List the reasons why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders.

Name or corporate name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained
Mr. Julio Linares López	On September 17, 2012, Mr. Julio Linares López resigned from his post as COO of Telefónica, S.A. and his managerial post in the Telefónica Group and therefore went from being an Executive Director to being classified in the Other External Directors category.	Telefónica, S.A.
Mr. José Fernando de Almansa Moreno-Barreda	Mr. de Almansa was appointed a Member of the Board of Directors of Telefónica, S.A. with the qualification of independent Director, on February 26, 2003, following a favorable report from the Nominating, Compensation and Corporate Governance Committee. In accordance with the criteria established in the Unified Code on Good Governance with regard to the qualification of Directors and taking into account the concurrent circumstances in this specific case, the Company considers that Mr. Almansa belongs to the category of other external Directors, for the following reasons: He is an alternate Director (independent and non-proprietary) of Grupo Financiero BBVA Bancomer, S.A. de C.V. (controlling company of BBVA Group related to financial services in Mexico) and of BBVA Bancomer, S.A., and has never had an executive role. He was the CEO of the Mexican company Servicios Externos de Apoyo Empresarial, S.A. de C.V., belonging to the BBVA Group, until March 2008.	BBVA Bancomer

List any changes in the category of each director which have occurred during the year.

Name or corporate name	Date of	Previous classification	Current classification

of director	change		
Mr. Julio Linares López	09/17/2012	Executive	Other external
Ms. María Eva Castillo Sanz	09/17/2012	Independent	Executive
Mr. Peter Erskine	12/31/2012	Other external	Independent

B.1.4 Explain, when applicable, the reasons why proprietary directors have been appointed upon the request of shareholders who hold less than 5% of the share capital:

Name or corporate name of shareholder	Reasons
China Unicom (Hong Kong) Limited	As explained in section A.6 of this report, on January 23, 2011, expanding on their existing strategic partnership, Telefónica, S.A. and China Unicom (Hong Kong) Limited (China Unicom) signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica also agreed to propose the appointment of a board member nominated by China Unicom in the next General Shareholders Meeting, in accordance with prevailing legislation and the Company s Bylaws.
	The General Shareholders Meeting held on May 18, 2011 approved the appointment of China Unicom s nominee, Mr. Chang Xiaobing, as member of the Board of Directors in accordance with the addendum to the Strategic Partnership Agreement signed in January 2011. This commitment to China Unicom is a consequence of the Strategic Partnership, which is intended to strengthen Telefónica s position in the global communications market.

Provide details of any rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors. If so, explain why these requests have not been entertained:

No

B.1.5 Indicate whether any director has resigned from office before their term of office has expired, whether that director has given the board his/her reasons and through which channel. If made in writing to the whole board, list below the reasons given by that director:

Yes

Name of director	Reasons for resignation
Mr. David Arculus	Mr. David Arculus tendered his voluntary resignation as director of Telefónica, S.A. based on personal issues to the Chairman of the Board through a letter dated September 14, 2012. The rest of the Board was duly notified at the meeting held on September 17, 2012.

B.1.6 Indicate what powers, if any, have been delegated to the Chief Executive Officer:

Mr. César Alierta Izuel Executive Chairman (Chief Executive Officer)

The Chairman of the Company, as the Chief Executive Officer, has been expressly delegated all the powers of the Board of Directors, except those that cannot be delegated by Law, by the Company Bylaws, or by the Regulations of the Board of Directors which establishes, in Article 5.4, the competencies that the Board of Directors reserves itself, and may not delegate.

Article 5.4 specifically stipulates that the Board of Directors reserves the power to approve: (i) approve the general policies and strategies of the Company; (ii) evaluate the performance of the Board of Directors, its Committees and the Chairman; (iii) appoint Senior Executives, as well as the remuneration of Directors and Senior Executives; and (iv) decide strategic investments.

Table of Contents

2012 Financial Statements

Mr. José María Álvarez-Pallete Chief Operating Officer

The Chief Operating Officer has been delegated those powers of the Board of Directors related to the management of the business and the performance of the highest executive functions over all the Company s business areas, except those which cannot be delegated by Law, under the Company Bylaws or according to the Regulations of the Board of Directors.

B.1.7 List the directors, if any, who hold office as directors or executives in other companies belonging to the listed company s group:

Name or corporate name of director	Corporate name of the group company	Post
Mr. Alfonso Ferrari Herrero	Telefónica Chile, S.A.	Alternate Director
	Telefónica del Perú, S.A.A.	Director
Mr. Francisco Javier de Paz Mancho	Telefónica Brasil, S.A.	Director
	Telefónica de Argentina, S.A.	Director
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director
Mr. José Fernando de Almansa Moreno-Barreda	Telefónica Brasil, S.A.	Director
	Telefónica Móviles México, S.A. de C.V.	Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
Ms. María Eva Castillo Sanz	Telefónica Czech Republic, A.S.	Chairman of Supervisory Board
	Telefónica Deutschland Holding, A.G.	Chairman of Supervisory Board
	Telefónica Europe, Plc.	Chairwoman
Mr. Santiago Fernández Valbuena	Colombia Telecomunicaciones, S.A. Esp	Director
	Telefónica América, S.A.	Chairman

	Telefónica Brasil, S.A.	Vice Chairman
	Telefónica Capital, S.A.	Sole Director
	Telefónica Chile, S.A.	Alternate Director
	Telefónica Internacional, S.A.U.	Chairman
	Telefónica Móviles México, S.A. de C.V.	Vice Chairman

B.1.8 List any company board members who sit on the boards of directors of other non-group companies that are listed on official securities markets in Spain, insofar as these have been disclosed to the company:

Name or corporate name of director	Name of listed company	Post
Mr. César Alierta Izuel	International Consolidated Airlines Group, S.A. (IAG)	Director
Mr. Isidro Fainé Casas	Caixabank, S.A.	Chairman
	Abertis Infraestructuras, S.A.	Vice Chairman
Mr. Isidro Fainé Casas	Repsol YPF, S.A.	2nd Vice Chairman
	Vueling Airlines, S.A.	Director
	Abertis Infraestructuras, S.A.	Director
	Inversiones Mobiliarias Urquiola, S.A. SICAV	Chairman
Mr. Carlos Colomer Casellas	Ahorro Bursatil, S.A. SICAV	Chairman
Mr. Ignacio Moreno Martínez	Metrovacesa, S.A.	Chairman
Ms. María Eva Castillo Sanz	Bankia, S.A.	Director
Mr. Pablo Isla Alvarez de Tejera	Inditex, S.A.	Chairman- CEO

B.1.9 Indicate and, where appropriate, explain whether the company has established rules about the number of boards on which its directors may sit:

Yes

Explanation of rules

The Regulations of the Board of Directors (Article 29.2) establish as one of the obligations of the Directors that they must devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors.

B.1.10 In relation with Recommendation 8 of the Unified Good Governance Code, indicate the company s general policies and strategies that are reserved for approval by the board of directors in plenary session:

Investment and financing policy	Yes
Design of the structure of the corporate group	Yes
Corporate governance policy	Yes
Corporate social responsibility policy	Yes
The strategic or business plans, management targets and annual budgets	Yes
Remuneration and evaluation of senior officers	Yes
Risk control and management, and the periodic monitoring of internal information and control systems	Yes
Dividend policy, as well as the policies and limits applying to treasury stock	Yes

B.1.11 Complete the following tables on the aggregate remuneration paid to directors during the year:
a) In the reporting company:

Concept	**Thousands of euros**
Fixed remuneration	10,265
Variable remuneration	10,502
Per diems	263
Statutory compensation	0
Share options and/or other financial instruments	0
Other	26,868
Total	47,898

Other benefits	**Thousands of euros**
Advances	0
Loans	0
Pension funds and plans: Contributions	34
Pension funds and plans: Obligations	0
Life insurance premiums	94
Guarantees issued by the company in favor of directors	0

b) For company directors sitting on other governing bodies and/or holding senior management posts within group companies:

Concept	**Thousands of euros**
Fixed remuneration	1,557
Variable remuneration	0
Per diems	0
Statutory compensation	0
Share options and/or other financial instruments	0
Other	1,098
Total	2,655

Other benefits	**Thousands of euros**
Advances	0
Loans	0
Pension funds and plans: Contributions	0
Pension funds and plans: Obligations	0
Life insurance premiums	6
Guarantees issued by the company in favor of directors	0

c) Total remuneration by type of director:

Type of director	By the company	By the group
Executive	11,009	521
External proprietary	1,185	0
External independent	2,200	1,742
Other external	33,504	392
Total	47,898	2,655

d) Remuneration as a percentage of profit attributable to the parent company:

Total remuneration received by directors (in thousands of euros)	50,553
Total remuneration received by directors/profit attributable to parent company (%)	1.3

B.1.12 List any members of senior management who are not executive directors and indicate total remuneration paid to them during the year:

Name or corporate name	Post
Mr. Guillermo Ansaldo Lutz	General Manager of Global Resources
Mr. Matthew Key	Chairman Telefónica Digital
Mr. Eduardo Navarro de Carvalho	Director of Strategies and Partnerships
Mr. Ramiro Sánchez de Lerín García-Ovies	General Secretary and of the Board of Directors
Ángel Vilá Boix	General Manager of Finance and Corporate Development
Mr. Ignacio Cuesta Martín-Gil	Director, Internal Audit

Total remuneration received by senior management (in thousands of euros)	25,857

B.1.13 Identify, in aggregate terms, any indemnity or golden parachute clauses that exist for members of the senior management (including executive directors) of the company or of its group in the event of dismissal or changes in control. Indicate whether these agreements must be reported to and/or authorized by the governing bodies of the company or its group:

Number of beneficiaries	10

	Board of Directors	General Shareholders Meeting
Body authorizing clauses	Yes	No

Is the General Shareholders Meeting informed of such clauses?	Yes

B.1.14 Describe the procedures for establishing remuneration for Board members and the relevant provisions in the bylaws:

Process for establishing board members remuneration and relevant provisions in the bylaws

Directors compensation shall consist of a fixed and specific monthly remuneration for belonging to the Board of Directors, the Steering Committee and the Board s Advisory or Control Committees, and fees for attending meetings of the Advisory or Control committees. The amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders Meeting, which amount shall remain unchanged until and unless the shareholders decide to modify it. To this effect, the General Shareholders Meeting held on April 11, 2003 fixed the maximum gross annual sum for remuneration of the Board of Directors at 6 million euros.

The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors.

In accordance with Article 35 of the Regulations of the Board of Directors, Directors shall be entitled to receive the compensation set by the Board of Directors in accordance with the Bylaws and following a report of the Nominating, Compensation and Corporate Governance Committee.

To this effect and in accordance with article 5 of the same regulations, the Board of Directors expressly reserves the powers to approve both the remuneration policy for Directors and decisions on the remuneration of Directors.

The Nominating, Compensation and Corporate Governance Committee has the following powers and duties (article 22 of the Regulations of the Board of Directors):

- To propose to the Board of Directors, within the framework established in the Bylaws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them.

- To propose to the Board of Directors the extent and amount of the compensation, rights and remuneration of a financial nature, of the Chairman and the executive Directors, including the basic terms of their contracts, for the purpose of implementing said contracts.

- To prepare and propose to the Board of Directors an annual report regarding the compensation policy for Directors.

Additionally, apart from such compensation as is provided for under the previous section, other remuneration systems may be established, either indexed to the market value of the shares, or consisting of shares or share options for Directors. The application of such compensation systems must be authorized by the General Shareholders Meeting, which shall fix the share value that is to be taken as the term of reference thereof, the number of shares to be given to each Director, the exercise price of the share options, the term of this compensation system and such other terms and conditions as are deemed appropriate.

The remuneration systems set out in the preceding paragraphs, arising from membership of the Board of Directors, shall be deemed compatible with any other professional or work-based compensations to which the Directors may be entitled in consideration of whatever executive or advisory services they may provide for the Company other than such supervisory and decision- making duties as may pertain to their posts as Directors, which shall be subject to the applicable legal provisions.

Indicate whether the board has reserved for plenary approval the following decisions.

On the proposal of the company s chief executive, the appointment and removal of senior officers, and their compensation clauses.	Yes
Directors remuneration, and, in the case of executive directors, the additional consideration for their management duties and other contract conditions.	Yes

B.1.15 Indicate whether the Board of Directors approves a detailed remuneration policy and specify the points included:

Yes

The amount of the fixed components, itemized where necessary, of board and board committee attendance fees, with an estimate of the fixed annual payment they give rise to.	Yes
Variable components	Yes
The main characteristics of pension systems, including an estimate of their amount of annual equivalent cost.	Yes
The conditions that the contracts of executive directors exercising executive functions shall respect.	Yes

B.1.16 Indicate whether the board submits a report on the directors remuneration policy to the advisory vote of the General Shareholders Meeting, as a separate point on the agenda: Explain the points of the report regarding the remuneration policy as approved by the board for forthcoming years, the most significant departures in those policies with respect to that applied during the year in question and a global summary of how the remuneration policy was applied during the year. Describe the role played by the Remuneration Committee and whether external consultancy services have been procured, including the identity of the external consultants:

Yes

Issues governed by the remuneration policy

The annual report drawn up by Telefónica, S.A. regarding the policy for Directors compensation covers the following issues:

- Objectives of the compensation policy.
- Detailed structure of compensation.
- Scope of application and reference parameters for variable remuneration.
- Relative importance of variable remuneration with regard to fixed remuneration.
- Basic terms of the contracts of Executive Directors.

Changes in remuneration over time.

How the compensation policy was prepared

Role of the Remunerations Committee

To propose to the Board of Directors, within the framework established in the Bylaws, the compensation for the Directors.

To prepare and propose to the Board of Directors an annual report regarding the policy for Directors compensation.

Have external consultancy firms been used?	Yes
Identity of external consultants	Towers Watson

B.1.17 List any Board members who are likewise members of the boards of directors, or executives or employees of companies that own significant holdings in the listed company and/or group companies:

Name or corporate name of director	Name or corporate name of significant shareholder	Post
Mr. Isidro Fainé Casas	Caja de Ahorros y Pensiones de Barcelona, la Caixa	Chairman of Criteria Caixaholding, S.A. Chairman of Caja de Ahorros y Pensiones de Barcelona, la Caixa Chairman of Caixabank, S.A.
Mr. Antonio Massanell Lavilla	Caja de Ahorros y Pensiones de Barcelona, la Caixa	Director of Serveis Informátics de la Caixa, S.A. Director of Bousorama, S.A. General Manager of Caixabank, S.A. Director of Caixa Capital Risc, S.G.E.C.R., S.A. Chairman of Barcelona Digital Technological Centre Director of e-la Caixa, S.A. Director of Mediterranea Beach & Golf Community, S.A. Board member of Sociedad de gestión de activos procedentes de la reestructuración bancaria (SAREB for its initials in Spanish)
Mr. José Fernando de Almansa Moreno-Barreda	Banco Bilbao Vizcaya Argentaria, S.A.	Alternate Director of Grupo Financiero BBVA Bancomer, S.A. de C.V. Alternate Director of BBVA Bancomer, S.A.

List, if appropriate, any relevant relationships, other than those included under the previous heading, that link members of the Board of Directors with significant shareholders and/or their group companies.

Name or company name of director with relationship	Name or company name of significant shareholder with relationship	Description of relationship
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Early retirement. Formerly Wholesale and Investment Banking Manager.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman s Office

B.1.18 Indicate whether any changes have been made to the regulations of the Board of Directors during the year:

No

B.1.19 Indicate the procedures for appointing, re-electing, appraising and removing directors. List the competent bodies and the processes and criteria to be followed for each procedure.

Appointment

Telefónica s Bylaws state that the Board of Directors shall be composed of a minimum of five members and a maximum of twenty, to be appointed at the General Shareholders Meeting. The Board of Directors may, in accordance with the Corporate Enterprises Act and the Company Bylaws, provisionally co-opt Directors to fill any vacancies.

To this effect the Board of Directors shall have the power to fill, on an interim basis, any vacancies that may occur therein, by appointing, in such manner as is legally allowed, the persons who are to fill such vacancies until the holding of the next General Shareholders Meeting.

Also, in all cases, proposed appointments of Directors must follow the procedures set out in the Company s Bylaws and Regulations of the Board of Directors and be preceded by the appropriate favorable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the Committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must report, based on criteria of objectivity and the best interests of the Company, on proposals to appoint, re-appoint or remove Company Directors, taking into account the skills, knowledge and experience required of candidates to fill the vacancies.

In line with the provisions of its Regulations, the Board of Directors, exercising the right to fill vacancies by interim appointment and to propose appointments to the shareholders at the General Shareholders Meeting, shall ensure that, in the composition of the Board of Directors, external or non-executive Directors represent an ample majority over executive Directors. Similarly, the Board shall ensure that the total number of independent Directors represents at least one third of the total number of Board members.

Similarly the nature of each Director shall be explained by the Board of Directors to the shareholders at the General Shareholders Meeting at which the appointment thereof must be made or ratified. Furthermore, such nature shall be reviewed annually by the Board after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

In any case, and in the event of re-election or ratification of Directors by the General Shareholders Meeting, the report of the Nominating, Compensation and Corporate Governance Committee, or in the case of independent Directors, the proposal of said Committee, will contain an assessment of the work and effective time devoted to the post during the last period in which it was held by the proposed Director.

Lastly, both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that those proposed for the post of Director should be persons of recognized caliber, qualifications and experience, who are willing to devote the time and effort necessary to carrying out their functions, and shall take extreme care in the selection of persons to be appointed as independent Directors.

Re-election

Directors are appointed for a period of five years, and may be re-elected for one or more subsequent five-year periods.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Nominating, Compensation and Corporate Governance Committee, and in the case of independent Directors, by the corresponding proposal by the Committee.

Evaluation

In accordance with the Regulations of the Board of Directors, the latter reserves expressly the duty to approve on a regular basis its functioning and the functioning of its Committees, it being the duty of the Nominating, Compensation and Corporate Governance Committee to organize and coordinate, together with the Chairman of the Board of Directors, the regular assessment of said Body.

In accordance with the above, it should be noted that the Board of Directors and its Committees carry out a periodic evaluation of the operation of the Board of Directors and of the Committees thereof in order to determine the opinion of Directors regarding the workings of these bodies and to establish any proposals for improvements to ensure the optimum working of the company s governing bodies.

Removal or dismissal

Directors shall cease to hold office when the term for which they were appointed expires, or when so resolved by the shareholders at the General Shareholders Meeting in the exercise of the powers legally granted to them.

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board alter a report from the Nominating, Compensation and Corporate Governance Committee. Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

The removal of independent Directors may also be proposed as a result of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company s capital.

B.1.20 Indicate the cases in which directors must resign.
In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation in the following cases:

a) When they cease to hold the executive positions to which their appointment as Directors is linked, or when the reasons for which they were appointed no longer exist.

b) When they are affected by any of the cases of incompatibility or prohibition established by statute.

c) When they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for having failed to fulfill any of their obligations as Directors.

d) When their remaining on the Board might affect the Company s credit or reputation in the market or otherwise jeopardize its interests.

The conditions listed above under Recommendation B.1.19 Removal must also be taken into consideration.

B.1.21 Indicate whether the duties of chief executive officer fall upon the Chairman of the Board of Directors. If so, describe the measures taken to limit the risk of powers being concentrated in a single person:

Yes

Measures for limiting risk

Pursuant to the provisions of the Regulations of the Board of Directors, the actions of the Chairman must follow the criteria established by the General Shareholders Meeting, the Board of Directors and the Board Committees at all times.

Likewise, all agreements or decisions of particular significance for the Company must be previously submitted for the approval of the Board of Directors or the relevant Board Committee, as the case may be.

The Board of Directors reserves the power to approve: the general policies and strategies of the Company; the evaluation of the Board, its Committees and its Chairman; the appointment of senior executive officers, as well as the compensation policy for Directors and senior executive officers; and strategic investments.

In addition, reports and proposals from the different Board Committees are required for the adoption of certain resolutions.

It is important to emphasize that the Chairman does not hold the casting vote within the Board of Directors.

The Board of Directors of the Company, at its meeting held on December 19, 2007, agreed to appoint Mr. Julio Linares López as the Chief Executive (Chief Operating Officer) of Telefónica, S.A., reporting directly to the Chairman and with responsibility over all of Telefónica Group s Business Units. On September 17, 2012, Julio Linares López was replaced as the Company s Chief Operating Officer by the director José María Álvarez-Pallete.

Indicate, and if necessary, explain whether rules have been established that enable any of the independent directors to convene board meetings or include new items on the agenda, to coordinate and voice the concerns of external directors and oversee the evaluation by the Board of Directors.

No

B.1.22. Are qualified majorities, other than legal majorities, required for any type of decisions?

No

Describe how resolutions are adopted by the Board of Directors and specify, at least, the minimum attendance quorum and the type of majority for adopting resolutions.

Description of resolution:

	All resolutions
Quorum	**%**
Personal or proxy attendance of one half plus one of all Directors.	50.01
Type of majority	**%**
Resolutions shall be adopted by a majority of votes cast by the Directors present at the meeting in person or by proxy, except in those instances in which the Law requires the favorable vote of a greater number of Directors for the validity of specific resolutions and in particular for: (i) the appointment of Directors not holding a minimum of shares representing a nominal value of 3,000 euros, (Article 25 of the Company Bylaws) and (ii) for the appointment of Chairman, Vice Chairman, CEO or member of the Executive Commission, when the requirements explained in the following section shall apply.	50.01

B.1.23 Indicate whether there are any specific requirements, apart from those relating to the directors, to be appointed Chairman.
Yes

Description of requirements

In order for a Director to be appointed Chairman, said Director must have served on the Board for at least three years prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

B.1.24. Indicate whether the Chairman has the casting vote.
No

B.1.25 Indicate whether the bylaws or the regulations of the Board of Directors set any age limit for directors:
No

Age limit for Chairman	Age limit for CEO	Age limit for directors
0	0	0

B.1.26 Indicate whether the bylaws or the regulations of the Board of Directors set a limited term of office for independent directors:
No

Maximum number of years in office	0

B.1.27 If there are few or no female directors, explain the reasons and describe the initiatives adopted to remedy this situation

Explanation of reasons and initiatives

The search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to coopt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. María Eva Castillo Sanz as an Independent Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders Meeting of Telefónica held on April 22, 2008, and she was thus appointed as a Member of the Board of the Company for a term of five years. On September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent Director to an Executive Director.

Likewise, on December 19, 2007, the Board of Directors unanimously agreed, following a favorable report from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary of the Board of Directors of Telefónica.

Article 10.3. of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates (recognized caliber, qualifications and experience) and their ability to dedicate themselves to the functions of members of the board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.

Indicate in particular whether the Appointments and Remunerations Committee has established procedures to ensure the selection processes are not subject to implicit bias that will make it difficult to select female directors, and make a conscious effort to search for female candidates who have the required profile.

Yes

Indicate the main procedures

In accordance with article 10.3 of the Board Regulations, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as independent Directors.

B.128 Indicate whether there are any formal processes for granting proxies at Board meetings. If so, give brief details.

In accordance with Article 18 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavor to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Such proxies may be granted by letter or any other means that, in the Chairman s opinion, ensures the certainty and validity of the proxy granted.

B.1.29 Indicate the number of Board meetings held during the year and how many times the board has met without the Chairman s attendance and how many times the board has met without the Chairman s attendance:

Number of board meetings	14

Number of board meetings held in the absence of its chairman	0

Indicate how many meetings of the various board committees were held during the year.

Number of meetings of the Executive or Delegated Committee	15
Number of meetings of the Audit and Compliance Committee	9
Number of meetings of the Appointments and Remunerations Committee	11
Number of meetings of the Appointments Committee	0
Number of meetings of the Remunerations Committee	0

B.1.30