

Telefónica complies  
with the main national  
and international  
guidelines and  
requirements for  
Corporate Governance

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## Ownership

Corporate Governance in Telefónica

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## Ownership

Telefónica’s fully subscribed and paid-up share capital amounts to 4,921,130,397 euros, and is divided into 4,921,130,397 ordinary shares, of a single class and series, with a nominal value of (1) one euro each, represented by book entries.

In accordance with the information available in the Company, there is currently no natural or legal person that exercises, or may exercise control, directly or indirectly, individually or jointly, over Telefónica. There are, however, two shareholders with significant shareholdings, directly and indirectly, as is shown in the following table: Caja de Ahorros y Pensiones de Barcelona (La Caixa), and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), with 5.09% and 6.632% of the share capital, respectively.

### Shareholders with significant stakes

| Name or corporate name | % total share capital |
|------------------------|-----------------------|
| “La Caixa”             | 5.09%                 |
| BBVA                   | 6.63%                 |

Information as at December, 31, 2005

This chapter presents a summarised version of the Annual Report on Corporate Governance of Telefónica S.A. for FY 2005. This report, which addresses the requirements established in the Circular 1/2004, of March 17, of the Comisión Nacional del Mercado de Valores (Spanish Stock Exchange Commission), is published on an annual basis, and can be accessed through the Company's website for shareholders and investors. ([www.telefonica.es/investors](http://www.telefonica.es/investors)).

## Corporate Governance in Telefónica

### Principles of Corporate Governance

The basic corporate governance regulations of Telefónica are set out in the Company By-laws, in the Regulations of the General Shareholders Meeting and in the Regulations of the Board of Directors.

The Regulations of the General Shareholders' Meeting establishes the principles of organisation and its operation, offering shareholders a framework that guarantees and enables the exercise of their rights with regard to the General Shareholder's Meeting, as the governing body of the Company.

Likewise, the Regulations of the Board of Directors, as the founding rules of corporate governance for the Company, determine the principles guiding the actions of the Board of Directors, regulate its organisation and operation and establish the rules of conduct for its members.

In accordance with the foregoing, and as the basis of the governance structure of Telefónica, the Regulations of the Board of Directors of the Company determine the fundamental principles that guide the actions of the Board of Directors:

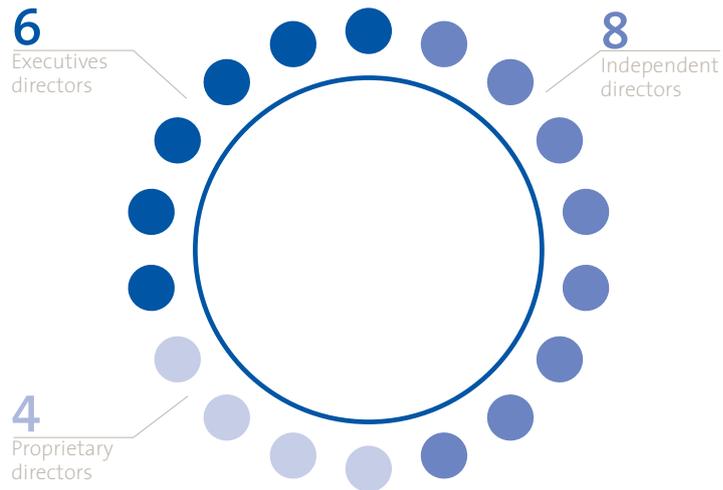
**With respect to corporate interest.** The Board of Directors executes its functions in accordance with corporate interest, understood as the Company's interest, and, in this respect, acts to guarantee the long term viability of the Company and maximise its value, whilst taking into account the plurality of legitimate public or private interests that converge in the execution of all business activities.

**With respect to its shareholders.** The Board of Directors, as the liaison between the shareholders and management, is responsible for setting up the necessary channels to be aware of the suggestions put forward by shareholders with respect to the corporate management. The Board of Directors also undertakes to guarantee equal treatment in its relations with shareholders.

**With respect to the market.** The Board undertakes to execute the acts and take the necessary measures to ensure the Company's transparency in financial markets, and to promote correct formation of the Company's share prices, particularly avoiding manipulation and abuse of privileged information.

The information regarding the General Shareholders' Meeting is detailed in the Shareholders chapter in this report

## Composition of the Board of Directors



### The Board of Directors

The Regulations of the Board of Directors establish it as a basically supervisory body controlling the Company's activity, while entrusting the day-to-day management of the business to the executive bodies and the management team. Moreover, and in keeping with the provisions of these Regulations, those powers that are legally or statutorily reserved for the Board of Directors may not be delegated, nor may any others necessary for the responsible performance of its basic supervisory and control duties.

Accordingly, and within the scope of its duties of supervision and control, the Board of Directors (i) determines the strategies and guidelines for the Company management, (ii) establishes the basis for corporate organisation to ensure its maximum efficiency, (iii) implements and oversees the suitable information procedures to report Company information to shareholders and the markets in general, (iv) makes decisions regarding business and financial transactions of particular importance to the Company and (v) approves the bases of its own organisation and operation to ensure the optimal fulfilment of these duties.

The Company By-Laws of Telefónica establish that the Board of Directors must comprise a minimum of five and a maximum of twenty Board Members. In April 2006, the Board of Directors of Telefónica was comprised of 18 Directors, of which 6 are Executive Directors, 4 are Proprietary Directors and 8 are Independent Directors.

### The Board of Directors Executive Committee

Subject to the legislation in force, the Board of Directors has expressly delegated all of its powers and attributes, save those that may not be legally or statutorily delegated, to an Executive Committee with general decision-making powers.

The relationship between the Board of Directors and its Executive Committee is based on the principle of transparency, such that the Board is always fully aware of the decisions adopted by the Committee. Thus, the Board of Directors is informed at each of its sessions of all the resolutions adopted by the Executive Committee, distributing a summary of the minutes of the Committee sessions for this purpose to all the Board members. The Board then proceeds to ratify these resolutions. Moreover, the election of the members of the Board of Directors to the Executive Committee must have the backing of, at least, two thirds of the Board of Directors.

## Telefónica's Board of Directors' Committees

| Board of Directors' Committee                     | Non-executive board members | Executive board members | No. of sessions 2005 |
|---|-----------------------------|-------------------------|----------------------|
| Executive Committee                               | 4                           | 4                       | 19                   |
| Audit and Control                                 | 4                           | 0                       | 12                   |
| Nominating, Compensation and Corporate Governance | 4                           | 0                       | 10                   |
| Regulation  | 3                           | 1                       | 9                    |
| Human Resources and Corporate Reputation          | 4                           | 0                       | 5                    |
| Service Quality and Customer Service              | 3                           | 1                       | 4                    |
| International Affairs                             | 5                           | 0                       | 6                    |

### The Board of Directors' Consultative or Control Committees

The Board of Directors of Telefónica has constituted several consultative or control Committees –precisely six- which it entrusts with the continual study and monitoring of areas of particular relevance for the Company's good governance, or for the monographic analysis of certain significant aspects or issues where such study is appropriate. These Committees are not corporate bodies, but rather are structured as instruments to serve the Board of Directors, which receives the conclusions reached in the matters and issues the Committees are instructed to study.

Among the consultative or control Committees constituted by the Board of Directors of Telefónica, are those that have been specifically recommended:

Audit and Control Committee, established in 1997, is regulated by the Company By-Laws and the Board Regulations. It verifies both the financial information and the annual accounts of the Company, ensuring that all the financial information is prepared in accordance with the same professional principles and practices. Its responsibilities are mainly (i) to know the financial information process and evaluate the accounting verification system, (ii) to safeguard the independence of the external auditor, supervising their work and serving as a liaison between the Board of Directors and the external auditor; (iii) to supervise the internal auditing services and (iv) to supervise compliance and integrity of the internal control systems for financial information.

The Nominating, Compensation and Corporate Governance Committee, regulated by the Board Regulations, has the following competencies: (i) to inform with regard to proposals for the appointment of Directors and other high-ranking officers of the Company and its subsidiaries, (ii), to approve the remuneration bands for the high-ranking officers of the Company, (iii) to approve the standard contracts for the high-ranking officers, (iv) to determine the remuneration scheme for the Chairman, (v) to inform and propose to the Board of Directors the retribution schemes for Directors and to revise them periodically, (vi) to inform of the incentive plans, (vii) to perform an annual analysis of the remuneration policy for Directors and high-ranking officers, (viii) to inform with regard to proposals for the appointment of members to the Board Committees, (ix), to prepare and keep a register of the status of the Directors and high-ranking officers of the Company, (x) to prepare the Annual Report on Corporate Governance and (xi) to exercise those competencies assigned to this Committee by the Board of Directors.

In addition, the Board of Directors deemed it convenient to constitute four additional consultative Committees: the Human Resources and Corporate Reputation Committee, the Regulation Committee, the Service Quality and Customer Service Committee and the International Affairs Committee.

## Directors

### Appointment

In accordance with the provisions of the Ley de Sociedades Anónimas (Spanish Corporations Act), the appointment of Directors is submitted for decision and approval by the General Shareholders' Meeting. In addition, and in accordance with the Regulations of the Board of Directors of the Company, the proposals for appointment are preceded by the relevant favourable report from the Nominating, Compensation and Corporate Governance Committee.

### Rights and Obligations

The Regulations of the Board of Directors specifically devote title V, comprised of nine articles, to the detailed description of the rights and obligations of Directors. This title sets out the duties arising from the obligations of diligence, fidelity and loyalty of Directors and, in particular, envisages situations of conflict of interest, the duty of confidentiality, the exploitation of business opportunities and the use of corporate assets.

Furthermore, the Regulations of the Board of Directors also includes the right of Directors to obtain the information and counsel necessary to perform their duties, as well as the establishment of the suitable channels for the exercise of such rights. In this respect, the Company has adopted the measures required to ensure that Directors are furnished in a timely manner with sufficient information specially drawn up to this effect, geared to preparing for the sessions of the Board and its Committees.

In accordance with the Regulations of the Board of Directors, the latter performs an annual evaluation of its performance and quality of its work on the occasion of the approval of the Annual Report on Corporate Governance.

### Remuneration Policy

As regards the remuneration policy for Directors, this policy is proposed, evaluated and reviewed by the Nominating, Compensation and Corporate Governance Committee, always in keeping with criteria of moderation. Currently there is no remuneration system linked to the market price of the company shares or that involves handing over shares or stock options to Board Directors.

On an annual basis, the Company provides information regarding the remuneration received by the Members of the Board of Directors, both in its Annual Report and in the Report on Corporate Governance, in accordance with the criteria established for each of these documents. .

### Composition of the Board of Directors of Telefónica S.A. and its Committees

|   | Type of Director | Executive Committee | Audit and Control | Nominating Compensation, and Corporate Governance | Human Resources and Corporate Reputation | Regulation | Service Quality and Customer Service | International Affairs |
|---|------------------|---------------------|-------------------|---|--|------------|--------------------------------------|-----------------------|
| César Alierta Izuel (Chairman)                    | ●                | ●                   |                   |   |  |            |                                      |                       |
| Isidro Fainé Casas (Vice Chairman)                | ●                | ●                   |                   |   |  |            |                                      |                       |
| Gregorio Villalabeitia Galarraga (Vicepresidente) | ●                | ●                   | ●                 |   |  | ●          |                                      | ●                     |
| Fernando de Almansa Moreno-Barreda                | ●                |                     |                   |   |  | ●          |                                      | ●                     |
| David Arculus                                     | ●                |                     |                   |   |  |            |                                      |                       |
| Maximino Carpio García                            | ●                | ●                   | ●                 | ●   |  |            |                                      |                       |
| Carlos Colomer Casellas                           | ●                | ●                   |                   |   |  |            | ●                                    |                       |
| Peter Erskine                                     | ●                | ●                   |                   |   |  |            |                                      |                       |
| Alfonso Ferrari Herrero                           | ●                |                     |                   | ●   | ●  |            |                                      | ●                     |
| Gonzalo Hinojosa Fernández de Angulo              | ●                |                     | ●                 | ●   |  |            | ●                                    | ●                     |
| Pablo Isla Álvarez de Tejera                      | ●                |                     |                   | ●   | ●  |            |                                      |                       |
| Luis Lada Díaz                                    | ●                |                     |                   |   |  |            | ●                                    |                       |
| Julio Linares López                               | ●                | ●                   |                   |   |  | ●          |                                      |                       |
| Antonio Massanell Lavilla                         | ●                |                     | ●                 |   | ●  |            | ●                                    |                       |
| Vitalino Manuel Nafría Aznar                      | ●                |                     |                   |   |  |            |                                      |                       |
| Enrique Used Aznar                                | ●                |                     |                   |   | ●  | ●          |                                      | ●                     |
| Mario Eduardo Vázquez                             | ●                |                     |                   |   |  |            |                                      |                       |
| Antonio Viana-Baptista                            | ●                | ●                   |                   |   |  |            |                                      |                       |

#### Non member Secretary

|                                      |  |   |   |   |  |   |  |  |
|--------------------------------------|--|---|---|---|--|---|--|--|
| Ramiro Sánchez de Lerín García-Ovies |  | ● | ● | ● |  | ● |  |  |
|--------------------------------------|--|---|---|---|--|---|--|--|

- Executive
- Proprietary
- Independent
- Chairman
- Director

CASE STUDY

Handbook of Internal Control for Financial Information Reporting

The Sarbanes-Oxley Act affects companies listed on US financial markets and establishes, among their obligations, the need for senior managers of companies to evaluate the internal control systems regarding financial information reporting as a necessary condition for ensuring reliability.

Telefónica has considered this legal requirement as an opportunity for improvement and, far from merely complying with the law, it has fully developed its internal control structures, control mechanisms and applied evaluation procedures.

As a result of this experience, the “Manual de Control Interno para el Reporte de la Información Financiera” (Handbook of Internal Control for Financial Information Reporting) has been published, with three main goals:

- **To share** the knowledge acquired
- **To transmit** to the markets Telefónica’s commitment to the development of good corporate governance practices
- **To provide** an easier understanding of the model developed, with a practical handbook for all its users or users of information reported by Telefónica with reference to its Internal Control Model for Financial Reporting (SEC, rating agencies...)

## Transparency of the Information for Shareholders

### Regulations for Reporting to Markets

In 2003, The Board of Directors of Telefónica approved the “Regulations on Communication of Information to the Markets”, which includes the legal requirements that affect Telefónica derived both from the Spanish law and from international laws applicable to the Company due to its shares being listed on other stock markets. In accordance with these Regulations, the Company disseminates immediately and simultaneously to the markets where it is present all the information that could be considered relevant, and therefore must be communicated to the market.

Likewise, these communications are published on the Company’s website.

### Independence of the External Auditor

Among the main competencies of the Audit and Control Committee is to propose to the Board of Directors, for submittal to the General Shareholders’ Meeting, the appointment of the Accounts Auditor, as well as the terms and conditions of contract, the scope of the auditor’s professional mandate and the renewal or not of their appointment.

The External Auditor has direct access to the Audit and Control Committee, and regularly takes part in its meetings, without the presence of the administrator when necessary.

In line with the legal requirements established by American regulations, the contracting of any service from the External Auditor of the Company must always be previously approved by the Audit and Control Committee. In addition, contracting services other than account auditing must be done in strict compliance with the Spanish Auditing Act and the Sarbanes-Oxley Act published in the United States, and its regulations. In this sense, the amount corresponding to work other than auditing with regard to the total amount invoiced by the auditing firm was 11% in FY 2005.

## Risk Control Systems

Telefónica carries out constant monitoring of the most significant risks that could affect the main companies that form part of its Group. To this aim it has a Corporate Model that is applied periodically and homogeneously in the Companies of the Group, allowing the evaluation of both the importance of each of the risks that could affect the companies, and the degree of control over each of the risks.

Thus, the Group has a risk map that allows it to identify those risks that require specific control and monitoring, prioritised in accordance with their importance. In addition, the model has a matrix that includes all the operational processes where each of the risks considered are managed, in order to allow the evaluation of the established controls and be able to have reasonable certainty that they will not materialise.

The identification of these risks and processes is carried out by the Internal Auditing Office, which is responsible for the internal control of the Group. Its results are informed periodically to Telefónica's Audit and Control Committee.

The 50 risks considered in the model are classified in the following categories:

- Business process risks: (operational risks, integrity risks, management and human resources risks, technological risks and financial risks).
- Information risks: (operational, financial and strategic)
- Contextual risks: (competition; shareholder relations; availability of resources; political and economic environment; legal and fiscal; regulations and changes in the sector).

# Créditos del informe

## Departments that collaborated in the preparation of the report

| Capítulo                      | Áreas implicadas  |
|-------------------------------|---|
| 01 Corporate Governance       | Secretariat General / Internal Auditing Department  |
| 02 Identity                   | Communication (Brand, Reputation and CSR) / Human Resources Office / Sponsorship / Internal Auditing Department   |
| 03 Driving Force for Progress | Finance (Consolidation, Management Control), Tax, Regulatory Affairs, Innovation, Telefónica I+D, Institutional Relations, Information Systems, Investor Relations  |
| 04 Customers                  | Corporate Marketing Development / Quality, marketing and customer service departments of the main business lines (Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica) / Secretariat General / Communication / Security                                  |
| 05 Shareholders               | Shareholders' Office / Investor Relations / Secretariat General   |
| 06 Employees                  | Corporate Human Resources / Human Resources Departments of the main lines of business (Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica, TPI, Terra, Atento, T-Gestiona) / Communication / Health and Safety / Fundación Telefónica / ATAM / Fonditel |
| 07 Society<br>Telefónica      | Main lines of business (Telefónica de España, Latinoamérica, Telefónica Móviles) / Institutional Relations / Management Control / Regulatory Affairs / Reputation and Corporate Social Responsibility / Fundación Telefónica / ATAM / Sponsorship                       |
| 08 Environment                | Internal Auditing / Reputation and Corporate Social Responsibility / Environmental Departments of the main lines of business (Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica)   |
| 09 Suppliers                  | Purchasing / Internal Auditing / Reputation and Corporate Responsibility  |
| 10 Media                      | Communication   |
| Annex 1: About the Report     | Reputation and Corporate Responsibility   |
| Annex 2: Verification Report  | Ernst&Young. Report   |
| Coordination                  | Reputation, Brand and Corporate Social Responsibility (G.D. of Communication)   |

