Red Eléctrica Corporación, S.A.

Annual Accounts

31 December 2016

Directors' Report

2016

(With Independent Auditor's Report Thereon)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

KPMG Auditores, S.L.
Paseo de la Castellana, 259 C
28046 Madrid

Independent Auditor's Report on the Annual Accounts

(Translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

To the Shareholders of
Red Eléctrica Corporación, S.A.

Report on the Annual Accounts

We have audited the accompanying annual accounts of Red Eléctrica Corporación, S.A. (the "Company"), which comprise the balance sheet at 31 December 2016, the income statement, statement of changes in equity and statement of cash flows for the year then ended, and notes.

Directors' Responsibility for the Annual Accounts

The Directors are responsible for the preparation of the accompanying annual accounts in such a way that they give a true and fair view of the equity, financial position and financial performance of Red Eléctrica Corporación, S.A. in accordance with the financial reporting framework applicable to the entity in Spain, specified in note 2 to the accompanying annual accounts, and for such internal control that they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the annual accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the annual accounts taken as a whole.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying annual accounts give a true and fair view, in all material respects, of the equity and financial position of Red Eléctrica Corporación, S.A. at 31 December 2016, its financial performance and its cash flows for the year then ended in accordance with the applicable financial reporting framework and, in particular, with the accounting principles and criteria set forth therein.

Report on Other Legal and Regulatory Requirements

The accompanying directors' report for 2016 contains such explanations as the Directors consider relevant to the situation of the Company, its business performance and other matters, and is not an integral part of the annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the annual accounts for 2016. Our work as auditors is limited to the verification of the directors' report within the scope described in this paragraph and does not include a review of information other than that obtained from the accounting records of the Company.

KPMG Auditores, S.L.

(*Signed on original in Spanish*)

Ana Fernández Poderós

23 February 2017

RED ELÉCTRICA CORPORACIÓN, S.A.
BALANCE SHEETS
AT 31 DECEMBER 2016 AND 2015
IN THOUSANDS OF EUROS

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

	31 DECEMBER 2016	31 DECEMBER 2015
NON-CURRENT ASSETS	**2.006.257**	**1.468.037**
Property, plant and equipment (note 5)	**61.816**	**58.505**
Land and buildings	59.180	57.045
Other installations, machinery, equipment, furniture and other items	668	866
Under construction and advances	1.968	594
Investment property (note 6)	**2.429**	**2.473**
Land	629	629
Buildings	1.800	1.844
Non-current investments in Group companies and associates	**1.938.570**	**1.400.943**
Equity instruments (note 8)	1.232.943	1.232.943
Loans to companies (note 22)	700.302	168.000
Non-current interest on loans to companies (note 22)	5.325	-
Non-current investments (note 12)	**1.811**	**4.448**
Equity instruments	1.765	4.435
Loans to third parties	33	-
Other financial assets	13	13
Deferred tax assets (note 17)	**1.631**	**1.668**
CURRENT ASSETS	**551.875**	**960.620**
Trade and other receivables (note 13)	**107**	**825**
Trade receivables from Group companies and associates	-	4
Other receivables	75	821
Personnel	3	-
Public entities, other	29	-
Current investments in Group companies and associates (note 22)	**547.424**	**959.631**
Loans to companies	547.424	959.631
Current investments	**11**	**12**
Other financial assets	11	12
Prepayments for current assets	**54**	**32**
Cash and cash equivalents	**4.279**	**120**
Cash	4.279	120
TOTAL ASSETS	**2.558.132**	**2.428.657**
EQUITY (note 14)	**2.393.197**	**2.283.244**
Capital and reserves	**2.376.469**	**2.268.994**
Capital	270.540	270.540
Reserves	1.719.249	1.651.405
(Own shares and equity holdings)	(36.739)	(33.076)
Profit for the year	551.836	500.207
(Interim dividend)	(128.417)	(120.082)
Valuation adjustments	**16.728**	**14.250**
NON-CURRENT LIABILITIES	**14.154**	**12.131**
Non-current provisions (note 15)	**3.371**	**3.320**
Non-current payables (note 16)	**4.530**	**16**
Derivatives	4.514	-
Other liabilities	16	16
Group companies and associates, non-current (note 22)	**1.565**	**1.546**
Deferred tax liabilities (note 17)	**4.688**	**7.249**
CURRENT LIABILITIES	**150.781**	**133.282**
Current payables (note 18)	**134.535**	**125.209**
Loans and borrowings	983	13
Other current payables	133.552	125.196
Group companies and associates, current (note 22)	**1.721**	**1.375**
Trade and other payables (note 19)	**14.525**	**6.698**
Other payables	2.542	2.483
Personnel	317	253
Current tax liabilities	11.570	3.778
Public entities, other	96	184
TOTAL EQUITY AND LIABILITIES	**2.558.132**	**2.428.657**

Notes 1 to 30 form an integral part of the accompanying annual accounts.

RED ELÉCTRICA CORPORACIÓN, S.A.
INCOME STATEMENTS
FOR 2016 AND 2015
IN THOUSANDS OF EUROS

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

	2016	2015
Revenue (note 21-a)	**557.848**	**507.739**
Dividends	533.967	481.697
Group companies and associates	533.967	477.131
Other	-	4.566
Finance income on securities and other financial instruments of Group companies and associates	23.881	26.042
Supplies	**(16)**	**-**
Raw materials and consumables used	(16)	-
Other operating income	**10.389**	**10.327**
Non-trading and other operating income	10.389	10.327
Personnel expenses (note 21-b)	**(3.621)**	**(3.045)**
Salaries and wages	(3.384)	(2.863)
Employee benefits expense	(92)	(65)
Other items and employee benefits	(145)	(117)
Other operating expenses	**(3.956)**	**(6.713)**
External services	(3.309)	(6.112)
Taxes	(647)	(601)
Depreciation and amortisation (notes 5 and 6)	**(1.709)**	**(1.665)**
RESULTS FROM OPERATING ACTIVITIES	**558.935**	**506.643**
Finance income (note 21-c)	**1.694**	**1.256**
Marketable securities and other financial instruments	1.694	1.256
Other	1.694	1.256
Finance costs (note 21-c)	**(2.694)**	**(28)**
Other	(2.693)	(28)
Provision adjustments	(1)	-
Change in fair value of financial instruments (note 11)	**(717)**	**-**
Trading portfolio and other	(717)	-
Exchange gains/(losses)	**16**	**(1)**
NET FINANCE INCOME/COST	**(1.701)**	**1.227**
PROFIT BEFORE INCOME TAX	**557.234**	**507.870**
Income tax (note 17)	**(5.398)**	**(7.663)**
PROFIT FROM CONTINUING OPERATIONS	**551.836**	**500.207**
PROFIT FOR THE YEAR	**551.836**	**500.207**

Notes 1 to 30 form an integral part of the accompanying annual accounts.

RED ELÉCTRICA CORPORACIÓN, S.A.
STATEMENTS OF TOTAL CHANGES IN EQUITY
AT 31 DECEMBER 2016 AND 2015
IN THOUSANDS OF EUROS

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

	Subscribed capital	Reserves	(Own shares)	Prior years' profit and loss	Profit for the year	(Interim dividend)	**Subtotal Capital and reserves**	Valuation adjustments	**Total equity**
Balance at 31 December 2014	270.540	1.513.891	(10.390)	-	465.069	(112.463)	**2.126.647**	7.950	**2.134.597**
Total recognised income and expense	-	(28)	-	-	500.207	-	**500.179**	6.300	**506.479**
Transactions with shareholders or owners									
(-) Distribution of dividends	-	-	-	(405.687)	-	(7.619)	**(413.306)**	-	**(413.306)**
Net transactions with own shares	-	2.890	(22.686)	-	-	-	**(19.796)**	-	**(19.796)**
Other changes in equity									
Distribution of prior year's profit	-	-	-	465.069	(465.069)	-	**-**	-	**-**
2014 profit transferred to reserves	-	60.245	-	(59.382)	-	-	**863**	-	**863**
Other movements in 2015	-	74.407	-	-	-	-	**74.407**	-	**74.407**
Balance at 31 December 2015	270.540	1.651.405	(33.076)	-	500.207	(120.082)	**2.268.994**	14.250	**2.283.244**
Total recognised income and expense	-	(4)	-	-	551.836	-	**551.832**	2.478	**554.310**
Transactions with shareholders or owners									
(-) Distribution of dividends	-	-		(433.827)	-	(8.335)	**(442.162)**	-	**(442.162)**
Net transactions with own shares	-	475	(3.663)	-	-	-	**(3.188)**	-	**(3.188)**
Other changes in equity									
Distribution of prior year's profit	-	-	-	500.207	(500.207)	-	**-**	-	**-**
2015 profit transferred to reserves	-	67.373	-	(66.380)	-	-	**993**	-	**993**
Other movements in 2016	-	-	-	-	-	-	**-**	-	**-**
Balance at 31 December 2016	270.540	1.719.249	(36.739)	-	551.836	(128.417)	**2.376.469**	16.728	**2.393.197**

Notes 1 to 30 form an integral part of the accompanying annual accounts.

RED ELÉCTRICA CORPORACIÓN, S.A.
STATEMENTS OF RECOGNISED INCOME AND EXPENSE
AT 31 DECEMBER 2016 AND 2015
IN THOUSANDS OF EUROS

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

	2016	2015
Profit for the year	**551.836**	**500.207**
Measurement of financial instruments	-	8.400
Cash flow hedges	-	-
Grants, donations and bequests received	-	-
Actuarial gains and losses and other adjustments	(5)	(37)
Tax effect	2.479	(2.091)
Income and expense recognised directly in equity	**2.474**	**6.272**
Measurement of financial instruments	-	-
Cash flow hedges	-	-
Grants, donations and bequests received	-	-
Tax effect	-	-
Amounts transferred to the income statement	**-**	**-**
Total recognised income and expense	**554.310**	**506.479**

Notes 1 to 30 form an integral part of the accompanying annual accounts.

RED ELÉCTRICA CORPORACIÓN, S.A.
STATEMENTS OF CASH FLOWS
AT 31 DECEMBER 2016 AND 2015
IN THOUSANDS OF EUROS

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

STATEMENTS OF CASH FLOWS	**2016**	**2015**
CASH FLOWS FROM OPERATING ACTIVITIES	**561.763**	**439.559**
Profit for the year before tax	**557.234**	**507.870**
Adjustments for:	**(554.205)**	**(507.299)**
Depreciation and amortisation	1.709	1.665
Change in provisions	233	113
Finance income	(559.542)	(508.995)
Finance costs	2.694	28
Exchange (gains)/losses	(16)	-
Change in fair value of financial instruments	717	-
Other income and expense	-	(110)
Changes in operating assets and liabilities	**(7.090)**	**(43.342)**
Trade and other receivables	721	(736)
Other current assets	(21)	(14)
Other current assets – Group companies and associates	(7.885)	(40.170)
Trade and other payables	95	(2.422)
Other cash flows from operating activities	**565.824**	**482.330**
Interest paid	(1.215)	(28)
Dividends received	533.967	481.697
Interest received	26.598	222
Income tax paid	6.662	439
Other amounts paid/received	(188)	-
CASH FLOWS USED IN INVESTING ACTIVITIES	**(115.721)**	**(14.803)**
Payments for investments	**(150.740)**	**(14.803)**
Group companies and associates	(138.504)	(5.000)
Property, plant and equipment, intangible assets and investment property	(4.407)	(679)
Other financial assets	(7.782)	(9.124)
Other assets	(47)	-
Proceeds from sale of investments	**35.019**	**-**
Group companies and associates	35.019	-
CASH FLOWS USED IN FINANCING ACTIVITIES	**(441.878)**	**(424.874)**
Proceeds from and payments for equity instruments	**(3.188)**	**(19.796)**
Acquisition and sale of own equity instruments	(3.188)	(19.796)
Proceeds from and payments for financial liability instruments	**(5.856)**	**(253)**
Loans and borrowings	(5.856)	(253)
Dividends and interest on other equity instruments paid	**(432.834)**	**(404.825)**
Dividends	(432.834)	(404.825)
EFFECT OF EXCHANGE RATE FLUCTUATIONS	**(5)**	**-**
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	**4.159**	**(118)**
Cash and cash equivalents at beginning of year	**120**	**238**
Cash and cash equivalents at year end	**4.279**	**120**

Notes 1 to 30 form an integral part of the accompanying annual accounts.

Notes to the Annual Accounts 2016

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

Contents

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

1. ACTIVITIES OF THE COMPANY

Red Eléctrica Corporación, S.A. (hereinafter the Company) was incorporated in 1985 and its registered office is located in Alcobendas (Madrid). The Company's principal activities are as follows:

- Managing the corporate Group, which comprises investments in the share capital of its Group companies and investees.
- Rendering assistance and support services to its investees.
- Operating the buildings owned by the Company.

2. BASIS OF PRESENTATION OF THE ANNUAL ACCOUNTS

a) True and fair view

The accompanying annual accounts were authorised for issue by the Company's directors at their board meeting held on 22 February 2017 and have been prepared to give a true and fair view of the Company’s equity and financial position at 31 December 2016, as well as the results of its operations, changes in equity and cash flows for the year then ended.

The figures disclosed in the annual accounts are expressed in thousands of Euros, the Company's functional and presentation currency, rounded off to the nearest thousand. The annual accounts have been prepared on the basis of the accounting records of the Company in accordance with prevailing legislation and the Spanish General Chart of Accounts approved by Royal Decree 1514/2007 and the amendments thereto contained in Royal Decree-Law 1159/2010.

The Company holds investments in subsidiaries. Consequently, in accordance with prevailing legislation, the Company is the parent of a group of companies. Pursuant to generally accepted accounting principles in Spain, annual accounts must be prepared to give a true and fair view of the financial position of the Company, the results of operations and changes in its equity and cash flows. Details of investments in Group companies are provided in note 8.

The Company files separate consolidated annual accounts in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) through Regulation (EC) No 1606/2002/EC of the European Parliament and of the Council, and the related interpretations (IFRIC) adopted by the European Union.

The annual accounts for 2015 were approved by the shareholders at their general meeting held on 15 April 2016. The annual accounts for 2016 are currently pending approval by the shareholders. However, the directors of the Company consider that these annual accounts will be approved with no changes.

b) Mandatory accounting principles

The Company has not omitted any mandatory accounting principle with a material effect on the annual accounts.

c) Estimates and assumptions

The preparation of the annual accounts requires Company management to make judgements, estimates and assumptions that affect the application of accounting standards and the amounts of assets, liabilities, income and expenses. Estimates and assumptions are based on past experience and other factors that are considered reasonable given the circumstances. Actual results could differ from these estimates.

The annual accounts for 2016 occasionally include estimates calculated by management of the Company, and subsequently endorsed by its sole director, to quantify certain assets, liabilities, income, expenses and commitments disclosed therein. These estimates are essentially as follows:

- Estimated recoverability of assets
- Estimated useful lives of property, plant and equipment.
- Assumptions used in the actuarial calculations.
- Assumptions and estimates used in measuring the fair value of derivative financial instruments.
- Liabilities are generally recognised when it is probable that an obligation will give rise to an indemnity or a payment. The Company assesses and estimates amounts to be settled in the future, including additional amounts for income tax, contractual obligations, pending lawsuit settlements and other liabilities. These estimates are subject to the interpretation of existing facts and circumstances, projected future events and the estimated financial effect of those events.

To facilitate comprehension of the annual accounts, details of the different estimates and assumptions are provided in each separate note.

The Company has taken out insurance policies to cover the risk of possible claims that might be lodged by third parties in relation to its activities.

Although estimates are based on the best information available at 31 December 2016, future events may require increases or decreases in these estimates in subsequent years, which would be accounted for prospectively in the corresponding income statement as a change in accounting estimates, as required by the Spanish General Chart of Accounts.

d) Comparative information

The balance sheet, income statement, statement of changes in equity, statement of cash flows and the notes thereto for 2016 include comparative figures for the prior year, which formed part of the annual accounts for 2015.

3. PROPOSED DISTRIBUTION OF PROFIT

The proposed distribution of profit for the year ended 31 December 2016, prepared by the directors and pending approval by the shareholders at the general meeting, is as follows (in thousands of Euros):

Profit for the year	551,836

Total	551,836
	=======
DISTRIBUTION	
Voluntary reserves	72,273
Capitalisation reserve	15,406
Dividends:	
Interim dividend	128,417
Supplementary dividend	335,740

Total	551,836
	=======

This proposed distribution entails a supplementary dividend of Euros 0.6205 per share, which would result in a total dividend for the year of Euros 0.8587 per share, calculated on the basis of total shares.

The interim dividend for the year is explained in note 14.

4. SIGNIFICANT ACCOUNTING PRINCIPLES

The accounting principles used in preparing the accompanying annual accounts are as follows:

a) Property, plant and equipment

Property, plant and equipment mainly comprise land and buildings and are measured at cost of construction or acquisition, as applicable. Cost of construction includes the following items, where applicable:

- Borrowing costs accrued on external financing during the construction period.
- Operating costs directly related with property, plant and equipment constructed for projects executed under the supervision and management of the Company.

The Company transfers work in progress to property, plant and equipment in use provided that the assets are in working condition.

Costs incurred to enlarge or improve items of property, plant and equipment which increase capacity or productivity or extend the useful life of the asset are capitalised as an increase in the cost of the related asset.

Repair and maintenance costs on property, plant and equipment that do not increase productivity or capacity and which do not lengthen the useful life of the assets are charged as expenses when incurred.

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful life of the assets, which is the period during which the Company expects to use the assets, applying the following rates:

	Annual depreciation rate
Buildings	2%-10%
Other installations	4%-25%

The Company periodically assesses the depreciation criteria taking into account the useful life of its assets. There have been no significant changes in the depreciation criteria compared to the prior year.

The Company reviews the residual values and useful lives of assets and adjusts them, if necessary, at the end of each reporting period.

b) Investment property

The Company measures its investment property at cost of acquisition. The market value of the Company's investment property is disclosed in note 6.

Investment property, except land, is depreciated on a straight-line basis over the estimated useful life, which is the period during which the Company expects to use the assets (annual depreciation rate of 2%).

c) Leases

The Company classifies leases on the basis of whether substantially all the risks and rewards incidental to ownership of the leased asset are transferred.

Leases under which the lessor maintains a significant part of the risks and rewards of ownership are classified as operating leases.

Leases under which the significant risks and rewards of ownership of the goods are transferred to the Company are classified as finance leases. Assets recognised as finance leases are presented in the balance sheet based on the nature of the leased asset.

d) Financial assets

The Company classifies its financial assets into the following categories:

- Loans and receivables: non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not intended for trading in the near term. These assets are classified as current, except those maturing in over 12 months after the reporting date, which are classified as non-current.

  Loans are initially recognised at fair value, including transaction costs incurred in arranging the loan, and are subsequently measured at amortised cost, which is basically the amount granted, less repayments of the principal, plus accrued interest receivable.

  Receivables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method.

- Available-for-sale financial assets: investments that the Company intends to hold for an unspecified period of time which are likely to be disposed of to meet one-off liquidity needs or in response to interest rate fluctuations. They are classified as non-current, unless they are expected to be disposed of in less than one year and such disposal is feasible. These financial assets are measured at fair value, which is the quoted price at the reporting date in the case of securities quoted in an active market. Any gains or losses arising from changes in the fair value of these assets at the reporting date are recognised directly in equity until the assets are disposed of or impaired, whereupon the accumulated gains and losses are recognised in profit or loss. Impairment, where applicable, is calculated on the basis of discounted expected future cash flows. A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. Dividends from equity investments classified as available-for-sale are recognised in the income statement when the Company's right to receive payment is established.

  In the case of share capital increases by a subsidiary that are fully subscribed through a non-monetary contribution consisting of a portfolio of securities classified under available-for sale financial assets, the Company adopts the response to query 1, published in the Spanish Accounting and Auditing Institute's Official Gazette (BOICAC) no. 77/2009, and any gains or losses arising from changes in the fair value at the date of the non-monetary contribution therefore continue to be recognised in the Company's equity. As provided for in Recognition and Measurement Standard 9.2.5.3. of the Spanish General Chart of Accounts, when an investment was made in a group company, jointly controlled entity or associate before it was classified as such, and valuation adjustments for the investment were recognised directly in equity prior to this classification, these adjustments shall be maintained after classification, either until disposal or derecognition of the investment, at which point they shall be recognised in the income statement.

- Equity investments in Group companies and associates: these investments are measured at cost less any accumulated impairment. If there is objective evidence that the carrying amount is not recoverable, the amount of the impairment loss is measured as the difference between the carrying amount and the recoverable amount, the latter of which is understood as the higher of the fair value less costs to sell and the present value of estimated future cash flows from the investment. Unless better evidence of the recoverable amount is available, when estimating impairment of such investments, the investee’s equity is taken into consideration, corrected for any net unrealised gains existing at the measurement date. Impairment losses are recognised and reversed in the corresponding income statement.

- Cash and cash equivalents: Cash and cash equivalents include cash on hand, demand deposits in financial institutions and other short-term, highly liquid investments.

e) Impairment

The Company analyses the recoverability of its assets at each reporting date and whenever events or changes in circumstances indicate that the carrying amount might not be recoverable. Impairment is deemed to exist when the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised immediately in the income statement. An impairment loss is the difference between the carrying amount of an asset and its recoverable amount.

Recoverable amount is the higher of:

- Fair value less costs to sell
- Value in use

Recoverable amount is calculated on the basis of expected cash flows. Impairment is calculated for individual assets. Where the recoverable amount of an individual asset cannot be determined, the recoverable amount of the cash-generating unit (CGU) to which that asset belongs is calculated. Any reversals are recognised in the income statement.

f) Equity

The share capital of the Company is represented by ordinary shares.

Interim dividends are recognised as a reduction in equity for the year in which the dividend is declared, based on the consensus of the board of directors. Supplementary dividends are not deducted from equity until approved by the shareholders at their general meeting.

The consideration paid by the Company in the acquisition of own shares, including any directly attributable incremental costs, is deducted from equity until the shares are cancelled, reissued or disposed of. If these shares are subsequently sold, any amount received, net of any incremental costs directly attributable to the transaction, is recognised in equity.

g) Provisions

- Employee benefits
  - Pension obligations

    The Company has defined contribution plans, whereby the benefit receivable by an employee upon retirement – based on one or more factors such as age, fund returns, years of service or remuneration – is determined by the contributions made. A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity, and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

- Other long-term employee benefits

  Other long-term employee benefits include defined benefit plans for benefits other than pensions (such as medical insurance) for the Company's serving personnel. The expected costs of these benefits are recognised over the working life of the employees. These obligations are measured each year by independent qualified actuaries. Changes in actuarial assumptions are recognised, net of taxes, in reserves under equity in the year in which they arise, while the past service cost is recorded in the income statement.

  This item also includes deferred remuneration schemes, which are measured each year.

- Other provisions

  The Company makes provision for present obligations (legal or constructive) arising as a result of a past event whenever it is probable that an outflow of resources will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation. Provision is made when the liability or obligation is recognised.

  Provisions are measured at the present value of the estimated expenditure required to settle the obligation using a pre-tax interest rate that reflects the current market assessment of the time value of money and the specific risks of the obligation. The increase in the provision due to the passage of time is recognised as an interest expense.

h) Financial debt

Loans, payment obligations and similar commitments are initially recognised at the cash amount received, less transaction costs. Such debt is subsequently measured at amortised cost, using the effective interest method.

Financial debt is classified under current liabilities unless the debt falls due more than 12 months after the reporting date, in which case it is classified under non-current liabilities.

i) Transactions in currency other than the Euro

Transactions in currency other than the Euro are translated by applying the exchange rate in force at the transaction date. Exchange gains and losses arising during the year due to balances being translated at the exchange rate at the transaction date rather than the exchange rate prevailing on the date of collection or payment are recognised as income or expenses in the income statement.

Fixed income securities and balances receivable and payable in currencies other than the Euro at 31 December each year are translated at the closing exchange rate. Any exchange differences arising are recognised under exchange gains/losses in profit or loss.

Transactions conducted in foreign currencies for which the Company has chosen to mitigate currency risk by arranging financial derivatives or other hedging instruments are recorded using the criteria for derivative financial instruments and hedging transactions.

j) Derivative financial instruments and hedging transactions

Derivative financial instruments are initially recognised in the balance sheet at their fair value on the date the arrangement is executed (acquisition cost) and this fair value is subsequently adjusted as necessary. The criterion used to recognise the resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument and, if so, the nature of the hedged item.

The total fair value of derivative financial instruments is recognised under non-current assets or liabilities if the residual maturity of the hedged item is more than 12 months, and under current assets or liabilities if the residual maturity is less than 12 months.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, whether that price is directly observable or estimated using another valuation technique.

A hedging instrument is considered highly effective when the changes in fair value or in the cash flows of the hedged items are offset by the changes in fair value or in the cash flows of the hedging instrument with an effectiveness ranging from 80% to 125%.

The Company documents the relationship between the hedging instruments and the hedged assets or liabilities, its risk management objectives and its hedging strategy at the inception of the hedge. The Company also documents its assessment, at inception and on an ongoing basis, of whether the hedging derivatives used are highly effective in offsetting changes in the hedged item's fair value or cash flows.

Details of the fair value of the derivatives used to hedge currency risk are disclosed in note 11.

k) Trade payables

Trade payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method. However, trade payables falling due in less than one year that have no contractual interest rate and are expected to be settled in the short term are measured at their nominal amount.

l) Income and expense

Income and expenses are recognised on an accruals basis, irrespective of payments and receipts.

Interest income is recognised using the effective interest method. Dividends are recognised when the right to receive payment is established.

The Company, as the Parent of the Red Eléctrica Group, has adopted the Spanish Accounting and Auditing Institute's (ICAC) response to the query (Ref: 546/09) of 23 July 2009, regarding the classification for accounting purposes of a holding company's income and expenses in individual accounts and the method for determining revenues, and classifies dividends from investments held in investees and interest on loans extended to these companies as revenues.

m) Taxation

The income tax expense or tax income for the year comprises current tax and deferred tax. Current and deferred taxes are recognised as income or an expense and included in profit or loss for the year, except to the extent that the tax arises from a transaction or event that is recognised in the same year, directly in equity, or from a business combination.

Current tax is the estimated tax payable for the year using the enacted tax rates applicable to the current year and to any adjustment to tax payable in respect of previous years.

Tax credits and deductions arising from economic events occurring in the year are deducted from the income tax expense, unless there are doubts as to whether they can be realised.

Deferred taxes and the income tax expense are calculated and recognised using the liability method, based on temporary differences arising between the balances recognised in the financial information and those used for tax purposes. This method entails calculating deferred tax assets and liabilities on the basis of the differences between the carrying amount of the assets and liabilities and their tax base, applying the tax rates that are objectively expected to apply to the years when the assets are realised and the liabilities settled.

Deferred tax assets are recognised provided that it is probable that sufficient taxable profits will be available against which the deductible temporary differences can be utilised.

As the Parent of the tax group, the Company records the total consolidated income tax payable (recoverable) with a debit (credit) to receivables from (payables to) Group companies and associates.

n) Insurance

The Company has taken out various insurance policies to cover the risks to which it is exposed through its activities. These risks mainly comprise damage that could be caused to its facilities and possible claims that might be lodged by third parties due to the Company's activities. Insurance premium expenses are recognised in the income statement on an accruals basis. Payouts from insurance companies in respect of claims are recognised in the income statement applying the matching of income and expenses principle.

o) Share-based payments

The Company has implemented share purchase schemes whereby employees can opt to receive part of their annual remuneration in the form of shares in the Company. This remuneration is measured based on the closing quotation of these Company shares at the delivery date. The costs incurred on such schemes are recognised under personnel expenses in the income statement. All shares delivered as payment are taken from the own shares held the Company.

p) Transactions between Group companies

Transactions between Group companies are recognised at the fair value of the consideration given or received. The difference between this value and the amount agreed is recognised in line with the underlying economic substance of the transaction.

5. PROPERTY, PLANT AND EQUIPMENT

Movement in property, plant and equipment and details of accumulated depreciation and impairment during 2016 and 2015, in thousands of Euros, are as follows:

	31 December 2014	Additions	Disposals	Transfers	31 December 2015	Additions	Disposals	Transfers	31 December 2016
Cost									
Land and buildings	71,325	85	-	1,786	73,196	-	-	3,463	76,659
Other installations, machinery, equipment, furniture and other items	14,850	-	-	-	14,850	-	-	139	14,989
Under construction and advances	1,786	594	-	(1,786)	594	4,976	-	(3,602)	1,968
	------------	------------	------------	------------	------------	------------	------------	------------	------------
Total cost	87,961	679	-	-	88,640	4,976	-	-	93,616
Accumulated depreciation									
Buildings	(14,872)	(1,279)	-	-	(16,151)	(1,328)	-	-	(17,479)
Other installations, machinery, equipment, furniture and other items	(13,642)	(342)	-	-	(13,984)	(337)	-	-	(14,321)
	------------	------------	------------	------------	------------	------------	------------	------------	------------
Total accumulated depreciation	(28,514)	(1,621)	-	-	(30,135)	(1,665)	-	-	(31,800)
Impairment of installations	-	-	-	-	-	-	-	-	-
	========	========	========	========	========	========	========	========	========
Carrying amount	59,447	(942)	-	-	58,505	3,311	-	-	61,816
	========	========	========	========	========	========	========	========	========

Additions to property, plant and equipment under construction in 2016 essentially reflect the acquisition of an office building in Santa Cruz de Tenerife and the adaptation of an office building in Tres Cantos (Madrid).

Additions to property, plant and equipment under construction in 2015 comprised the adaptation of the aforementioned building in Tres Cantos.

Transfers from property, plant and equipment under construction to land and buildings during 2016 and 2015 comprise buildings.

At 31 December 2016 the Company has fully depreciated property, plant and equipment with a cost of Euros 14,055 thousand (Euros 13,611 thousand in 2015), Euros 13,191 thousand of which are other installations (Euros 12,746 thousand in 2015).

Law 16/2012, which introduced several tax measures to consolidate public finances and boost economic activity, provided for the revaluation of property, plant and equipment and/or investment property using the ratios set forth in this Law, with a credit to a revaluation reserve under equity. According to the Spanish Accounting and Auditing Institute Resolution of 31 January 2013, any revaluation of balances should be recognised in the annual accounts for 2013. Pursuant to this Law, the Company revalued its property, plant and equipment on 1 January 2013, making a single tax payment of 5% of the revalued amount.

The amount resulting from the revaluation, net of the single 5% tax payment, was credited to reserves (see note 14). The balancing entries were recognised under the pertinent revalued asset items, with no changes to the accumulated depreciation recorded at that date (Euros 6,304 thousand under land and buildings and Euros 56 thousand under other installations).

The net increase in value deriving from the revaluation is depreciated over the remaining useful life of the revalued assets. The revaluation has led to an increase of Euros 186 thousand in the depreciation charge for 2016 (Euros 191 thousand in 2015).

6. INVESTMENT PROPERTY

Movement in investment property in 2016 and 2015, in thousands of Euros, is as follows:

	31 December 2014	Additions	Transfers	31 December 2015	Additions	Transfers	31 December 2016
Investment property	2,910	-	-	2,910	-	-	2,910
	------------	------------	------------	------------	------------	------------	------------
Total cost	2,910	-	-	2,910	-	-	2,910
Accumulated depreciation	(393)	(44)	-	(437)	(44)	-	(481)
	------------	------------	------------	------------	------------	------------	------------
Total accumulated depreciation	(393)	(44)	-	(437)	(44)	-	(481)
	=====	=====	=====	=====	=====	=====	=====
Carrying amount	2,517	(44)	-	2,473	(44)	-	2,429
	=====	=====	=====	=====	=====	=====	=====

Investment property has a market value of approximately Euros 3 million in both 2016 and 2015 and does not generate or incur significant operating income or expenses.

7. OPERATING LEASES

The Company has leased certain assets to Group companies. The types of assets leased under operating leases, in thousands of Euros, are as follows:

	31 December 2016	31 December 2015
Cost		
Land and buildings	70,243	66,780
Other installations, machinery, equipment, furniture and other items	14,212	14,074
	-----------	-----------
Total cost	84,455	80,854
Accumulated depreciation		
Buildings	(17,260)	(16,039)
Other installations, machinery, equipment, furniture and other items	(13,917)	(13,774)
	-----------	-----------
Total accumulated depreciation	(31,177)	(29,813)
	========	========
Carrying amount	53,278	51,041
	========	========

The Company has entered into operating lease agreements with Red Eléctrica de España, S.A.U. (REE), Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (REINTEL) and Red Eléctrica Internacional, S.A.U., (REI) whereby it leases, to these Group companies, areas inside the buildings it owns. These agreements are renewed periodically and in 2016 generated income of Euros 9,928 thousand from REE (Euros 9,933 thousand in 2015), Euros 240 thousand from REINTEL (Euros 257 thousand in 2015) and Euros 5 thousand from REI (Euros 5 thousand in 2015).

8. INVESTMENTS IN GROUP COMPANIES AND ASSOCIATES

At 31 December 2016 and 2015, none of the Group companies in which the Company holds a direct or indirect interest is listed on the stock exchange.

Details of investments in Group companies and associates at 31 December 2016, in thousands of Euros, are as follows:

RED ELÉCTRICA CORPORACIÓN S.A.
Details of equity investments at 31 December 2016
(Expressed in thousands of Euros)

Company - Registered office - Principal activity	Percentage ownership (1) Direct	Percentage ownership (1) Indirect	Carrying amount	Equity of investees (2) Paid-in share capital	Share premium	Reserves	Other items	Profit/(loss) for the year	Operating profit/(loss)	Dividends received
A) Fully consolidated subsidiaries										
Red Eléctrica de España, S.A.U. (REE) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Transmission, operation of the Spanish electricity system and management of the transmission network.	100%	-	1,014,326	800,006	54,319	627,216	(184,138)	586,015	940,414	533,753
Red Eléctrica Internacional, S.A.U. (REI) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - International investments. Rendering of advisory, engineering and construction services. - Performance of electricity activities outside the Spanish electricity system.	100%	-	132,640	60,010	72,630	30,333	(603)	2,971	3,743	-
Red Eléctrica Infraestructuras de Telecomunicación, S.A.U.(REINTEL) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Rendering of advisory, engineering, construction and telecommunications services.	100%	-	74,417	30,000	44,417	18,083	(1,248)	20,285	36,638	-
Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN) - Calle Juan de Quesada, 9. Las Palmas de Gran Canaria. (Spain). - Construction of energy storage facilities in non-mainland and isolated systems.	100%	-	5,000	5,000	-	-	(92)	1	-	-
Red Eléctrica de España Finance, B.V. (RBV) - Hoogoorddreef 15. Amsterdam (Netherlands). - Financing activities. - Incorporated in 2003 in the Netherlands to issue debt to finance the Red Eléctrica Group.	100%	-	2,000	18	1,982	-	-	148	(167)	214
Red Eléctrica Financiaciones, S.A.U. (REF) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Financing activities.	100%	-	60	60	-	7,756	-	2,204	(209)	-
Redcor Reaseguros, S.A (REDCOR) - 26, Rue Louvigny. (Luxembourg). - Reinsurance activities. - Incorporated in 2010 in Luxembourg in order to reinsure the risks of the Group companies, thereby guaranteeing better access to international reinsurance markets.	100%	-	4,500	4,500	-	-	34,009	3,885	4,924	-
Red Eléctrica Andina, S.A. (REA) - Av. Alfonso Ugarte Nº 536 Cercado. Arequipa (Peru). - Rendering of line and substation maintenance services.	-	100%(a)	31	36	-	1,017	-	50	114	-
Red Eléctrica del Sur, S.A. (REDESUR) - Juan de la Fuente, 453. Lima (Peru). - Electricity transmission and operation and maintenance of electricity transmission networks.	-	55%(a)	8,930	12,332	-	13,244	-	4,012	8,649	-
Transmisora Eléctrica del Sur , S.A. (TESUR) - Juan de la Fuente, 453. Lima (Peru). - Electricity transmission and operation and maintenance of electricity transmission networks.	-	55%(d)	32,386	36,811	-	(26)	(3,180)	645	3,303	-
Transmisora Eléctrica del Sur 2 , S.A. (TESUR 2) - Juan de la Fuente, 453. Lima (Peru). - Electricity transmission and operation and maintenance of electricity transmission networks.	-	66.25%(c)	20,711	21,512	-	(110)	-	(193)	(232)	-
Transmisora Eléctrica del Sur 3 , S.A. (TESUR 3) - Juan de la Fuente, 453. Lima (Peru). - Electricity transmission and operation and maintenance of electricity transmission networks.	-	100%(a)	4,744	4,743	-	-	4	(26)	(37)	-
Red Eléctrica Chile SpA (RECH) - Avenida El Golf nº40, piso 20. Comuna de Las Condes, Santiago (Chile) - Acquisition, holding, management and administration of securities.	-	100%(a)	103,896	104,354	-	-	(29)	(3,185)	(649)	-
B) Proportionately consolidated companies										
Interconexión Eléctrica Francia-España, S.A.S. (INELFE) - Tour Initiale, 1 Terrasse Bellini – 92919 Paris La Défense Cedex. Paris (France). - Study and execution of Spain-France interconnections.	-	50%(b)	1,000	2,000	-	2,445	12,006	(101)	(145)	-
C) Equity-accounted investees										
Transmisora Eléctrica del Norte S.A. (TEN) - Avenida Apoquindo N°3721, piso 6, Las Condes, Santiago (Chile) - Electricity transmission and operation and maintenance of electricity transmission networks.	-	50%(e)	200,616	69,136	-	-	(27,438)	(2,187)	(425)	-

(1) Equivalent to voting rights.
(2) As per the financial statements harmonised with the Company's accounting criteria and translated to Euros at the closing exchange rate.
(3) As per the audited financial statements harmonised with the Company's accounting criteria and translated to Euros at the average exchange rate.

(a) Investment through Red Eléctrica Internacional, S.A.U.
(b) Investment through Red Eléctrica de España, S.A.U.
(c) 25% investment through Red Eléctrica Internacional and 75% through REDESUR
(d) Investment through REDESUR
(e) Investment through Red Eléctrica Chile since 27 January 2016

The Company holds all of the share capital of REE, the company that performs the functions of transmission agent, system operator and transmission network manager of the Spanish electricity system subject to the provisions of Electricity Industry Law 24/2013 and related provisions formerly applicable to Red Eléctrica de España, S.A. as system operator and transmission network manager. The Company may not transfer the shares of this subsidiary, which conducts regulated activities in Spain, to third parties.

The Company holds all of the share capital of REI, through which all foreign activities are carried out. Details of the main transactions performed 2016 and 2015 are as follows:

- In Peru:

  Transmisora Eléctrica del Sur 3, S.A. (TESUR 3) was incorporated in February 2016 with registered office in Lima (Peru). Its principal activity comprises electricity transmission and the operation and maintenance of electricity transmission networks. TESUR 3 holds the concession for the 129 km, 220 kV Montalvo-Los Héroes line and its associated substations in Peru. Upon its incorporation, this company was wholly owned by REI.

  Transmisora Eléctrica del Sur 2, S.A. was incorporated in March 2015 with registered office in Lima (Peru). Its principal activity comprises electricity transmission and the operation and maintenance of electricity transmission networks. Upon its incorporation, this company was 25% owned by REI, whilst the remaining 75% interest was held by Red Eléctrica del Sur, S.A. (REDESUR).

  An agreement was signed in July 2015 for the sale of the shares in Transmisora Eléctrica del Sur, S.A. (TESUR) by REI (55% interest) and AC Capitales (45%) to REDESUR, which is now the sole shareholder of TESUR. REI holds 55% of the shares in REDESUR.

- In Chile:

  In November 2015 REI, as sole shareholder, incorporated Red Eléctrica Chile SpA (RECH), whose activity comprises the acquisition, holding, administration and management of the Group's investments in Chile. In January 2016, the agreement signed in 2015 for the acquisition by RECH of 50% of the share capital of Transmisora Eléctrica del Norte, S.A. (TEN) from the Chilean company E-CL, S.A., for an amount of US Dollars 217,560 thousand (Euros 199,816 thousand), was executed. TEN is carrying out the Mejillones-Cardones project, primarily comprising the construction of a 500 kV transmission line over a distance of approximately 580 km in the north of Chile.

In July 2015, the Company incorporated REINTEL following the spin-off, through a split-off, of the Telecommunications line of business from REI, with retrospective effect from 1 January 2015. The carrying amount of the investment in REINTEL at the date of its incorporation was Euros 74,417 thousand (see note 14).

In 2015, REI increased its capital through a non-monetary contribution valued at Euros 10 thousand, with a share premium of Euros 72,630 thousand. The capital increase was subscribed with the contribution of REC's investment in the share capital of Redes Energéticas Nacionais, SGPS, S.A. (hereinafter REN). The value of the investment at the date of its contribution was Euros 72,640 thousand (see note 14).

In September 2015, the Company incorporated Red Eléctrica Infraestructuras en Canarias S.A.U. (REINCAN), whose statutory activity comprises the construction of energy storage facilities in non-mainland and isolated systems.

9. FINANCIAL RISK MANAGEMENT POLICY

The Company's financial risk management policy establishes principles and guidelines to ensure that any significant risks that could affect the objectives and activities of the Group are identified, analysed, assessed, managed and controlled, and that these processes are carried out systematically and adhering to uniform criteria.

A summary of the main guidelines that comprise this policy is as follows:

- Risk management should be fundamentally proactive and directed towards the medium and long term, taking into account possible scenarios in an increasingly global environment.
- Risk should generally be managed in accordance with consistent criteria, distinguishing between the importance of the risk (probability/impact) and the investment and resources required to reduce it.
- Financial risk management should be focused on avoiding undesirable variations in the Company's core value, rather than generating extraordinary profits.

The Company's finance management is responsible for managing financial risk, ensuring consistency with the strategy and coordinating the risk management process, by identifying the main financial risks and defining the initiatives to be taken, based on different financial scenarios.

The methodology for identifying, measuring, monitoring and controlling risk, as well as the management indicators and measurement and control tools specific to each risk, are documented in the financial risk manual.

Currency risk

Currency risk management considers transaction risk arising on cash inflows and outflows in currencies other than the Euro.

With a view to reducing the currency risk on loans extended to the Group company RECH, the Company has arranged derivative financial instruments (cross currency swaps). These instruments allow variable-rate debt in Euros to be exchanged for variable-rate debt in US Dollars, thereby hedging future receipts in US Dollars.

Credit risk

The main risk to which the Company is exposed is credit risk, as debt transactions are carried out with the other Group companies, which assume the market and liquidity risks. Credit risk is managed through policies that contain certain requirements regarding counterparty credit quality, and further guarantees are requested when necessary. At 31 December 2016 the Company does not consider there to be any risk as regards the recoverability of receivables.

10. ANALYSIS OF FINANCIAL INSTRUMENTS

a) Analysis by category

At 31 December 2016 and 2015 the carrying amounts of each category of financial instruments, except investments in Group companies, are as follows (in thousands of Euros):

- **Financial assets**

	Financial instruments by category 31/12/2016		
	Available-for-sale financial assets	Loans and receivables	Total
Loans to third parties	-	33	33
Loans to Group companies and associates	-	705,627	705,627
Equity instruments	1,765	-	1,765
Other financial assets	-	13	13
Non-current	1,765	705,673	707,438
Loans to Group companies and associates	-	547,424	547,424
Other financial assets	-	11	11
Trade and other receivables	-	107	107
Current	-	547,542	547,542
Total	1,765	1,253,215	1,254,980

	Financial instruments by category 31/12/2015		
	Available-for-sale financial assets	Loans and receivables	Total
Loans to third parties	-	-	-
Loans to Group companies and associates	-	168,000	168,000
Equity instruments	4,435	-	4,435
Other financial assets	-	13	13
	------------	------------	------------
Non-current	4,435	168,013	172,448
	========	========	========
Loans to Group companies and associates	-	959,631	959,631
Other financial assets	-	12	12
Trade and other receivables	-	825	825
	------------	------------	------------
Current	-	960,468	960,468
	========	========	========
Total	4,435	1,128,481	1,132,916
	========	========	========

- **Financial liabilities**

	Financial instruments by category 31/12/2016		
	Debts and payables	Hedging derivatives	Total
Group companies and associates	1,565	-	1,565
Other financial liabilities	16	-	16
Derivative financial instruments	-	4,514	4,514
	------------	------------	------------
Non-current	1,581	4,514	6,095
	=======	=======	=======
Loans and borrowings	983	-	983
Group companies and associates	1,721	-	1,721
Current payables	133,552	-	133,552
Trade and other payables	14,525	-	14,525
	------------	------------	------------
Current	150,781	-	150,781
	=======	=======	=======
Total	152,362	4,514	156,876
	=======	=======	=======

	Financial instruments by category 31/12/2015		
	Debts and payables	Hedging derivatives	Total
Group companies and associates	1,546	-	1,546
Other financial liabilities	16	-	16
Derivative financial instruments	-	-	-
	------------	------------	------------
Non-current	1,562	-	1,562
	=======	=======	=======
Loans and borrowings	13	-	13
Group companies and associates	1,375	-	1,375
Current payables	125,196	-	125,196
Trade and other payables	6,698	-	6,698
	------------	------------	------------
Current	133,282	-	133,282
	=======	=======	=======
Total	134,844	-	134,844
	=======	=======	=======

b) Analysis by maturity

- **Financial assets**

	Maturity of financial assets		
	2017	Subsequent years	Total
Equity instruments	-	1,765	1,765
Loans to third parties	-	33	33
Loans to Group companies and associates	547,424	705,627	1,253,051
Other financial assets	11	13	24
Trade and other receivables	107	-	107
	------------	------------	------------
	547,542	707,438	1,254,980
	=========	=========	=========

- **Financial liabilities**

	Maturity of financial liabilities		
	2017	Subsequent years	Total
Loans and borrowings	983	-	983
Group companies and associates	1,721	1,565	3,286
Trade and other payables	148,077	-	148,077
Other financial liabilities	-	16	16
	------------	------------	------------
	150,781	1,581	152,362
	=========	=========	=========

An analysis by maturity of derivative financial instruments is provided in note 11.

11. DERIVATIVE FINANCIAL INSTRUMENTS

In line with its financial risk management policy, the Company has arranged derivative financial instruments (cross currency swaps). These instruments allow variable-rate debt in Euros to be exchanged for variable-rate debt in US Dollars, thereby hedging future receipts in US Dollars. The Company has no formal hedging relationships reflected in the balance sheet. Variations due to exchange rate fluctuations in derivative financial instruments are offset in the income statement against the corresponding variations arising from the non-current loan extended to the Group company RECH (see note 22). However, the formal hedging relationship is disclosed in the Group's consolidated annual accounts as hedges of net investments in US Dollars.

The Company has incorporated a credit risk adjustment to reflect own and counterparty risk in the fair value of derivatives using generally accepted measurement models.

When determining the credit risk adjustment, the Company applied a technique based on calculating total expected exposure (which considers current and potential exposure) through the use of simulations, adjusted for the probability of default over time and for loss given default allocable to the Company and to each counterparty.

The total expected exposure of derivative financial instruments is determined using observable market inputs, such as interest rate curves, exchange rates and volatilities based on market conditions at the measurement date.

The inputs used to determine own and counterparty credit risk (probability of default) are mostly based on own credit spreads and those of comparable companies currently traded on the market (credit default swap (CDS) curves, IRR of debt issues, etc.).

Furthermore, adjustments of fair value for credit risk take into account credit enhancements for guarantees and collateral when determining the loss given default to be used for each position. Loss given default is considered to be constant over time. A minimum recovery rate of 40% has been used in cases where there is no credit enhancement for guarantees or collateral.

As regards observable inputs, the Company uses mid-market prices obtained from reputable external information sources in the financial markets.

Details of derivative financial instruments by type at 31 December 2016, in thousands of Euros, are as follows:

			31/12/2016			
			Non-current		Current	
	Hedged principal	Maturity	Assets	Liabilities	Assets	Liabilities
Exchange rate hedge						
- Hedges of a net investment: Cross currency swap	150,000 thousand US Dollars	Up to 2021	-	(4,514)	-	-
			----------	----------	----------	----------
			-	(4,514)	-	-
			=======	=======	=======	=======

Details of these derivative financial instruments by expiry date are as follows:

	Hedged principal	Maturity	2017	2018	2019	2020	2021	2022 and thereafter	Total
Exchange rate hedge									
- Hedges of a net investment: Cross currency swap	150,000 thousand US Dollars	Up to 2021	-	-	-	-	(4,514)	-	(4,514)
			----------	----------	----------	----------	----------	----------	----------
			-	-	-	-	(4,514)	-	(4,514)
			=======	=======	=======	=======	=======	=======	=======

In 2016 the Company recognised an expense of Euros 717 thousand.

12. NON-CURRENT INVESTMENTS

Details of non-current investments at 31 December 2016 and 2015 are as follows (in thousands of Euros):

	31 December 2016	31 December 2015
Equity instruments	1,765	4,435
Loans to third parties	33	-
Other financial assets	13	13
	---------	---------
	1,811	4,448
	======	======

Equity instruments reflect the Euros 1,765 thousand investment in 8 economic interest groups (EIGs) (Euros 4,435 thousand in 11 EIGs in 2015) engaged in the lease of assets managed by an unrelated company, which retains most of the rewards and risks of the activity, while the Company only avails of the tax incentives regulated in Spanish legislation. The Company recognises the finance income generated due to the difference between income tax payable to the taxation authorities in respect of recognised tax losses incurred by the EIGs and the investments in those EIGs (see notes 17 and 21-c).

In 2015 the Company made a non-monetary contribution consisting of the investment in REN (a holding company that encompasses the operation and use of electricity transmission assets and various gas infrastructure in Portugal), in order to subscribe a share capital increase through a non-monetary contribution carried out by the Group company REI. The value of the investment at the date of its contribution was Euros 72,640 thousand.

13. TRADE AND OTHER RECEIVABLES

Details at 31 December 2016 and 2015, in thousands of Euros, are as follows:

	31 December 2016	31 December 2015
Trade receivables from Group companies and associates	-	4
Other receivables	75	821
Personnel	3	-
Public entities, other	29	-
	-----------	-----------
	107	825
	========	========

At 31 December 2016 and 2015 other receivables primarily reflect the outstanding amount in connection with the own shares sold.

At 31 December 2016 public entities, other include the value added tax (VAT) recoverable by the Company.

14. EQUITY

a) Capital risk management

The Group's management of its companies' capital is aimed at safeguarding their capacity to continue operating as a going concern, so as to provide shareholder remuneration while maintaining an optimum capital structure to reduce the cost of capital.

To maintain and adjust the capital structure, the Company can adjust the amount of dividends payable to shareholders, reimburse capital or issue shares.

Given the Company's activity and its investees' capacity to generate funds, the Company is not significantly exposed to capital risk.

b) Capital and reserves

- **Capital**

  On 11 July 2016 a 4-for-1 share split was carried out, reducing the par value of the Company's shares from Euros 2 to Euros 0.50 per share without modifying total share capital. The share split was approved by the shareholders at their ordinary general meeting on 15 April 2016.

  At 31 December 2016 the share capital of the Company is represented by 541,080,000 bearer shares with a par value of Euros 0.50 each, subscribed and fully paid, and carrying the same voting and profit-sharing rights. The shares are quoted on the four Spanish stock exchanges (135,270,000 shares with a par value of Euros 2 each at 31 December 2015).

  The Company, as Parent of the Red Eléctrica Group, is subject to the shareholder limitations stipulated in the twenty-third additional provision of Law 54/1997 of 27 November 1997 and article 30 of the Electricity Industry Law 24/2013 of 26 December 2013.

  Pursuant to this legislation, any individual or entity may hold investments in the Company, provided that the sum of their direct or indirect interests in its share capital does not exceed 5% and their voting rights do not surpass 3%. These shares may not be syndicated for any purpose. Voting rights at the Parent are limited to 1% in the case of entities that carry out activities in the electricity sector, and individuals and entities that hold direct or indirect interests exceeding 5% of the share capital of such companies, without prejudice to the limitations for generators and suppliers set forth in article 30 of Electricity Industry Law 24/2013 of 26 December 2013. The shareholder limitations with regard to the Parent's share capital are not applicable to Sociedad Estatal de Participaciones Industriales (SEPI), which in any event will continue to hold an interest of no less than 10%. At 31 December 2016 and 2015 SEPI holds a 20% interest in the Company's share capital.

- **Reserves**

  This item includes:

  - Legal reserve

    Spanish companies are obliged to transfer 10% of the profits for the year to a legal reserve until such reserve reaches an amount equal to 20% of the share capital. This reserve is not distributable to shareholders and may only be used to offset losses if no other reserves are available. Under certain circumstances, it may also be used to increase share capital. At 31 December 2016 and 2015 the legal reserve amounts to 20% of share capital (Euros 54,199 thousand).

- Revaluation reserve, Law 16/2012 of 27 December 2012

  In accordance with Law 16/2012 of 27 December 2012, which introduced several tax measures to consolidate public finances and boost economic activity, the Company revalued its property, plant and equipment. The associated revaluation reserve amounted to Euros 6,042 thousand, net of the 5% capital gains tax. There were no movements in the revaluation reserve during 2016.

  The revaluation is open to inspection by the Spanish taxation authorities for a three-year period from the date of filing the 2012 income tax return. Once this three-year period has elapsed, the balance may be used to offset losses or increase the Company's capital. Once a period of ten years has elapsed this balance may be released to freely distributable reserves. Nonetheless, this balance may only be distributed, indirectly or directly, when the revalued assets have been fully depreciated, transferred or derecognised.

- Other reserves

  Other reserves primarily include voluntary reserves of the Company and first-time application reserves, amounting to Euros 1,300,160 thousand and Euros 19,895 thousand, respectively, at 31 December 2016 (Euros 1,232,316 thousand and Euros 19,895 thousand, respectively, at 31 December 2015). Both of these reserves are freely distributable.

  At 31 December 2016 and 2015 this item also comprises statutory reserves totalling Euros 264,546 thousand, notably including the property, plant and equipment revaluation reserve amounting to Euros 247,022 thousand created by the Parent in 1996. This reserve may be used, free of taxation, to offset accounting losses and increase share capital or, ten years after its creation, and when the associated assets have been fully depreciated, it may be transferred to freely distributable reserves. Nonetheless, this balance may only be distributed, indirectly or directly, when the revalued assets have been fully depreciated, transferred or derecognised.

  Moreover, following the spin-off of the Telecommunications activity from REI to REINTEL, through a split-off, a reserve was generated in an amount of Euros 74,407 thousand in 2015, reflecting the difference between the value of the net assets spun off to REINTEL (Euros 74,417 thousand) and the value of the Company's investment in this business through REI. There was no change in the balance of this reserve in 2016

  As provided for by article 25 of Law 27/2014 of 27 November 2014, in 2015 the tax group headed by the Company created a capitalisation reserve of Euros 29,110 thousand, which is held by REE, as permitted by article 62.1 d) of the aforementioned Law. This reserve will be restricted for a period of five years. Each tax group company adjusted income tax for the year in connection with this reserve (see note 17).

The proposed appropriation to the capitalisation reserve for the year ended 31 December 2016, prepared by the directors and pending approval by the shareholders at the general meeting, is Euros 15,406 thousand (see note 3).

- **Own shares**

At 31 December 2016 the Company held 1,966,332 own shares representing 0.36% of its share capital (0.32% in 2015), with a total par value of Euros 983 thousand and an average acquisition price of Euros 18.68 per share. At 31 December 2015 prior to the aforementioned share split performed by the Company in 2016, the Company held 437,187 own shares, with a total par value of Euros 874 thousand and an average acquisition price of Euro 75.66 per share.

These shares have been recognised as a reduction in equity for an amount of Euros 36,739 thousand at 31 December 2016 (Euros 33,076 thousand in 2015).

The Company has complied with the requirements of article 509 of the Spanish Companies Act, which provides that the par value of acquired shares listed on official secondary markets, together with those already held by the Parent and its subsidiaries, must not exceed 10% of the share capital. The Group subsidiaries do not hold own shares or shares in the Company.

- **Profit for the year**

Profit for the year totals Euros 551,836 thousand (Euros 500,207 thousand in 2015).

- **Interim dividends and proposed distribution of dividends by the Company**

The interim dividend authorised by the board of directors in 2016 has been recognised as a Euros 128,417 thousand reduction in equity at 31 December 2016 (Euros 120,082 thousand at 31 December 2015).

On 20 December 2016 the Company's board of directors agreed to pay an interim dividend of Euros 0.2382 (gross) per share with a charge to 2016 profit, which was paid on 5 January 2017.

The cash flow forecast for the period from 30 November 2016 to 5 January 2017 indicated sufficient liquidity to allow the distribution of this dividend. As such, the following provisional liquidity statement was drawn up pursuant to article 277 section a) of the Spanish Companies Act:

Liquidity statement of Red Eléctrica Corporación, S.A.	Thousands of Euros
Available funds at 30/11/2016:	
Non-current credit facilities available	-
Current credit facilities available	159,316
Current investments and cash	910
Forecast collections:	
Current transactions	6
Financial transactions	142,066
Forecast payments:	
Current transactions	(33,157)
Financial transactions	-

Forecast available funds at 05/01/2017	**269,141**
	========

Based on the cash flow forecast at the approval date, no limitation on the availability of funds was or is expected to arise. Furthermore, as reflected in the accompanying annual accounts, and as foreseen at the distribution date, profit for 2016 allows for the distribution of this interim dividend.

c) Valuation adjustments

At 31 December 2016 and 2015 this item reflects the gains arising from the increase in the fair value of the investment held by the Company in REN up to the subscription of the capital increase in the Group company REI through a non-monetary contribution in 2015 (see notes 8 and 12).

These gains are recorded in equity until the disposal or derecognition of the investment, whereupon they are taken to profit and loss (see note 4-d).

15. NON-CURRENT PROVISIONS

Movement in 2016 and 2015, in thousands of Euros, is as follows:

	31 December 2014	Additions	Applications	Actuarial gains and losses	31 December 2015	Additions	Applications	Actuarial gains and losses	31 December 2016
Long-term employee benefits	169	113	-	38	320	134	(188)	5	271
Other provisions	3,000	-	-	-	3,000	100	-	-	3,100
	-----------	-----------	-----------	-----------	-----------	-----------	-----------	-----------	-----------
	3,169	113	-	38	3,320	234	(188)	5	3,371
	=======	=======	=======	=======	=======	=======	=======	=======	=======

Provisions for employee benefits include future commitments (medical insurance) undertaken by the Company on behalf of its employees for their retirement, calculated based on actuarial studies conducted by an independent expert. The following assumptions were used for 2016 and 2015:

	Actuarial assumptions	
	2016	2015
Discount rate	2.10%	2.33%
Cost increase	3.00%	3.00%
Mortality table	PERM/F 2000 new production	PERM/F 2000 new production

The effect of a one percentage point increase or decrease in the assumed medical insurance cost trend rates, in thousands of Euros, is as follows:

	+1%	-1%
Current service cost	2	(1)
Interest cost of net post-employment medical costs	-	-
Accumulated post-employment benefit obligation for medical insurance	27	(19)

Conversely, the effect of a decrease of half a percentage point in the discount rate used for medical insurance costs from 2.10% to 1.60%, in thousands of Euros, is as follows:

	Discount rate		
	2.10%	1.60%	Sensitivity
Current service cost	4.1	4.8	0.7
Interest cost of net post-employment medical costs	1.3	1.0	(0.3)
Accumulated post-employment benefit obligation for medical insurance	69	81	12

The accrued amounts are recognised as personnel expenses or finance costs, depending on their nature. Personnel expenses and finance costs recognised in the income statement for 2016 amount to Euros 4.1 thousand and Euros 1.3 thousand, respectively (Euros 3.8 thousand and Euros 0.5 thousand, respectively, in 2015). Any variations in the calculation of the present value of these obligations due to actuarial gains and losses are recognised as reserves under equity. The gross amount recognised during the year in this connection totalled Euros 5 thousand (Euros 38 thousand in 2015), which has been recorded under actuarial gains and losses in the table reflecting movement in this item.

Other provisions comprise annual allowances made by the Company to cover the possibility of unfavourable rulings in respect of claims lodged by third parties, and the provision made to cover amounts accrued by the chairman, which will be payable once he ceases to be a board member of the Company (see note 23).

16. NON-CURRENT PAYABLES

Details at 31 December 2016 and 2015 in thousands of Euros are as follows:

	31 December 2016	31 December 2015
Derivative financial instruments	4,514	-
Other liabilities	16	16
	------------	------------
	4,530	16
	========	========

The value of derivative financial instruments at 31 December 2016 is Euros 4,514 thousand. An analysis by maturity is provided in note 11.

At 31 December 2016 and 2015 other liabilities comprise non-current security deposits received amounting to Euros 16 thousand.

17. TAXATION

The Company has filed consolidated tax returns since 2002. The Company is the parent of tax group no. 57/02.

a) Reconciliation of accounting profit and the tax loss

Due to the treatment permitted by fiscal legislation of certain transactions, accounting profit differs from the tax loss. A reconciliation of accounting profit for 2016 and 2015 with the tax loss that the Company expects to declare after approval of the annual accounts is as follows (in thousands of Euros):

	2016	2015
Accounting profit for the year before tax	557,234	507,870
Permanent differences	(535,571)	(480,561)
	----------	----------
Taxable accounting income	21,663	27,309
Temporary differences:		
Originating in current year	5	1,756
Reversals of prior years	141	173
	----------	----------
	146	1,929
EIG charges	(46,075)	(34,798)
	----------	----------
Tax loss	(24,266)	(5,560)
	=======	=======

Permanent differences in 2016 and 2015 primarily reflect the dividends received from subsidiaries (mainly from REE) and the capitalisation reserve adjustment mentioned in letter b) of this note.

In 2016 and 2015, adjustments were made to the tax base to reflect recognition of the EIGs in which the Group has interests, amounting to Euros 46,075 thousand and Euros 34,798 thousand, respectively (see note 12).

b) Effective rate of income tax and reconciliation of accounting profit with the income tax expense

The income tax expense for the year is calculated as follows (in thousands of Euros):

	2016	2015
Accounting profit for the year before tax	557,234	507,870
Permanent differences	(535,571)	(480,561)
	----------	----------
Taxable accounting income	21,663	27,309
Tax rate	25%	28%
Tax at the current rate	5,416	7,647
Deductions	(178)	(59)
	----------	----------
Expense for the year	5,238	7,588
Foreign income tax	178	1
Expense due to changes in tax rate (Law 27/2014)	-	74
Other adjustments	(18)	-
	=======	=======
Income tax expense	5,398	7,663
	=======	=======
Effective tax rate	0.97%	1.51%
Current income tax	5,448	8,127
Deferred income tax	(32)	(538)
Expense due to changes in tax rate (Law 27/2014)	-	74
Other adjustments	(18)	-
	=======	=======
Income tax expense	5,398	7,663
	=======	=======

The effective rate of income tax is influenced by permanent differences, deductions and changes in the tax rate. The difference between the effective tax rate and the actual tax rate is primarily due to application of the exemption to prevent double taxation of dividends from significant interests in resident entities.

The decrease in the effective income tax rate in 2016 compared to 2015 is essentially due to the reduction in the general income tax rate from 28% in 2015 to 25% in 2016.

Permanent differences in 2016 and 2015 reflect the capitalisation reserve adjustment, as a result of the increase in equity, in accordance with article 25 of Income Tax Law 27/2014 of 27 November 2014. As permitted by article 62.1 d) of Law 27/2014, the capitalisation reserve for 2016 will be held in the Company, as head of the tax group (see note 14).

Deductions comprise those for international double taxation.

c) Deferred tax assets and liabilities

Temporary differences in the recognition of income and expenses for accounting and tax purposes at 31 December 2016 and 2015, and the corresponding cumulative tax effect (assets and liabilities), are as follows (in thousands of Euros):

	2016		2015	
	Income statement	Income and expense recognised in equity	Income statement	Income and expense recognised in equity
Deferred tax assets:				
Originating in prior years	1,664	4	1,168	(4)
Originating in current year	1	1	592	8
Reversals of prior years	(39)	-	(33)	-
	----------	----------	----------	----------
	(38)	1	559	8
Adjustments due to change in tax rate (Law 27/2014)	-	-	(63)	-
	----------	----------	----------	----------
	1,626	5	1,664	4
	======	======	======	======
Deferred tax liabilities:				
Originating in prior years	(2,501)	(4,748)	(2,469)	(2,649)
Originating in current year	-	-	(100)	(2,099)
Reversals of prior years	70	2,479	79	-
	----------	----------	----------	----------
	70	2,479	(21)	(2,099)
Adjustments due to change in tax rate (Law 27/2014)	-	-	(11)	-
Prior year adjustments	12	-	-	-
	----------	----------	----------	----------
	(2,419)	(2,269)	(2,501)	(4,748)
	=======	=======	=======	=======

Deferred tax assets in 2016 and 2015 include reversals of tax advances in 2013 and 2014 as a result of applying the limitation on the tax deductibility of depreciation and amortisation charges stipulated in article 7 of Law 16/2012 of 27 December 2012, which introduced several fiscal measures to consolidate public finances and boost economic activity, and as a result of the commencement, in 2015, of depreciation and amortisation for tax purposes of the net increase in value resulting from the revaluations applied to the balance sheet at 31 December 2012, pursuant to article 9 of the same Law, as well as the reversal of provisions.

Deferred tax liabilities essentially relate to the accelerated depreciation for tax purposes of certain fixed assets, the tax amortisation of goodwill and the impairment of foreign investments.

The notes to the Company's annual accounts for 2006 contain disclosures on the merger by absorption of Red de Alta Tensión, S.A.U. (REDALTA) and Infraestructuras de Alta Tensión S.A.U. (INALTA), as required by article 86 of Law 27/2014. The notes to the 2008 annual accounts include disclosures on the contribution to Red Eléctrica de España, S.A.U. of the branch of activities encompassing the duties of the system operator, transmission network manager and transmission agent of the Spanish electricity system. The notes to the annual accounts for 2015 include disclosures regarding the spin-off of the telecommunications services business to REINTEL, and the non-monetary contribution to REI of shares in REN.

d) Years open to inspection

In accordance with current legislation, taxes cannot be considered definitive until they have been inspected and agreed by the taxation authorities or before the inspection period has elapsed.

The Company has open to inspection by the taxation authorities all applicable taxes since 2013.

In July 2016 the taxation authorities initiated partial inspections of the Company in respect of corporate income tax for 2011 to 2014. These inspections are still ongoing at the 2016 year end.

Due to the different possible interpretations of tax legislation, additional tax liabilities could arise as a result of ongoing and future inspections, which cannot be objectively quantified at present. Nevertheless, the Company's board of directors does not expect that any additional liabilities that could eventually arise in the event of inspection would significantly affect the Company's future results.

18. CURRENT PAYABLES

Details at 31 December 2016 and 2015 in thousands of Euros are as follows:

	31 December 2016	31 December 2015
Loans and borrowings	983	13
Other current payables	133,552	125,196
	------------	------------
	134,535	125,209
	========	========

Current loans and borrowings at 31 December 2016 include Euros 139 thousand drawn down from credit facilities arranged by the Company (no amount drawn down at 31 December 2015). The credit facilities are denominated in US Dollars and the average interest rate for the period was 1.12%.

This item also reflects accrued interest payable on derivative financial instruments.

Details of other current payables are as follows (in thousands of Euros):

	31 December 2016	31 December 2015
Dividends	128,417	120,082
Suppliers of fixed assets and other payables	5,135	5,114
	133,552	125,196

19. TRADE AND OTHER PAYABLES

Details at 31 December 2016 and 2015 in thousands of Euros are as follows:

	31 December 2016	31 December 2015
Other payables	2,542	2,483
Personnel	317	253
Public entities	11,666	3,962
	14,525	6,698

Public entities include Euros 11,570 thousand at 31 December 2016 (Euros 3,778 thousand in 2015), reflecting the income tax payable recognised by the Company, as parent of the tax group.

20. AVERAGE SUPPLIER PAYMENT PERIOD "REPORTING REQUIREMENT", THIRD ADDITIONAL PROVISION OF LAW 15/2010 OF 5 JULY 2010

The Spanish Accounting and Auditing Institute (ICAC) resolution of 29 January 2016, concerning the information that must be disclosed in the notes to the annual accounts in relation to the average supplier payment period in commercial transactions, clarifies and systematises the information that trading companies must include in the notes to individual and consolidated annual accounts, in compliance with the reporting requirement of the third additional provision of Law 15/2010 of 5 July 2010, which amends Law 3/2004 of 29 December 2004, establishing measures to combat late payments in commercial transactions.

In accordance with the resolution, the information concerning late payments to suppliers for 2016 and 2015 is as follows:

	2016 Days	2015 Days
Average supplier payment period	38.6	37.8
Transactions paid ratio	38.6	38.3
Transactions payable ratio	38.9	21.1

	2016 Thousands of Euros	2015 Thousands of Euros
Total payments made	2,231	3,293
Total payments outstanding	106	85

21. INCOME AND EXPENSES

a) Revenue

Details at 31 December 2016 and 2015 are as follows (in thousands of Euros):

	31 December 2016	31 December 2015
Finance income on investments in equity instruments of Group companies and associates	533,967	477,131
Finance income on investments in equity instruments of third parties	-	4,566
Finance income on securities and other financial instruments of Group companies and associates	23,881	26,042
	-----------	-----------
	557,848	507,739
	========	========

At 31 December 2016 and 2015 finance income on investments in equity instruments of Group companies and associates reflects the dividends received from REE and RBV.

At 31 December 2015 finance income on investments in equity instruments of third parties reflected the dividends received from REN (see note 12).

At 31 December 2016 finance income on securities and other financial instruments of Group companies and associates comprises income from loan contracts entered into with REE, REINTEL and RECH (REE and REINTEL in 2015), as well as the credit facilities arranged with REE and RECH (REE and REINTEL in 2015) (see note 22).

Details of revenue in 2016 and 2015, by geographical area, are as follows:

	2016	2015
Domestic market	551,119	502,960
European Union	214	4,779
Other countries	6,515	-
	-----------	-----------
	557,848	507,739
	========	========

b) Personnel expenses

In 2016 and 2015 this item comprises the following (in thousands of Euros):

	31 December 2016	31 December 2015
Salaries and wages	3,384	2,863
Social Security	87	62
Contributions to pension funds and similar obligations	5	3
Other items and employee benefits	145	117
	-----------	-----------
	3,621	3,045
	========	========

Personnel expenses include the remuneration of the board of directors (see note 23).

Workforce

The average headcount of the Company in 2016 and 2015, distributed by professional category, is as follows:

	31 December 2016	31 December 2015
Executive chairman [(*)]	1	1
Managing director	1	-
Senior technicians	1	1
Specialist and administrative staff	4	3
	-------	-------
	7	5
	======	======

[(*)] Since 15 April 2016 executive functions have been transferred to the managing director (See note 23)

This distribution of the Company's employees at 31 December 2016 and 2015, by gender and category, is as follows:

	2016			2015		
	Male	Female	Total	Male	Female	Total
Executive chairman	1	-	1	1	-	1
Managing director	1	-	1	1	-	1
Senior technicians	-	1	1	-	1	1
Specialist and administrative staff	-	4	4	-	4	4
	------	------	------	------	------	------
	2	5	7	2	5	7
	=====	=====	=====	=====	=====	=====

No employees with a disability rating of 33% or higher formed part of the workforce in 2016 or 2015.

At 31 December 2016 the board of directors, including the managing director, comprises 11 members (12 members in 2015), of which 7 are men and 4 are women (7 men and 5 women in 2015). In July 2015, the Company's board of directors appointed a managing director.

c) Finance income and costs

In 2016 finance costs primarily reflect borrowing costs on loans and borrowings and derivative financial instruments.

In 2016 and 2015 finance income essentially comprises returns on the investments in the EIGs (see note 12).

22. BALANCES AND TRANSACTIONS WITH GROUP COMPANIES, ASSOCIATES AND RELATED PARTIES

Balances and transactions with Group companies and associates

All transactions with Group companies and associates have been carried out at market prices.

Details of receivables from and payables to Group companies and associates in 2016 and 2015 are as follows (in thousands of Euros):

	2016		2015	
	Loans and dividends	Payables	Loans and dividends	Payables
Red Eléctrica de España, S.A.U. (REE)	968,952	1,528	952,434	1,509
Red Eléctrica Internacional, S.A.U. (REI)	-	1,728	4	1,367
Red Eléctrica Financiaciones, S.A.U. (REF)	27	-	124	-
Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (REINTEL)	136,185	30	175,073	30
Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN)	260	-	-	15
Red Eléctrica Chile SpA (RECH)	147,627	-	-	-
Total Group companies	1,253,051	3,286	1,127,635	2,921

Loans and dividends receivable from REE primarily include the Euros 425 million loan arranged with that company on 1 July 2016, of which Euros 425 million had been drawn down at 31 December 2016 (Euros 425 million at 31 December 2015, from the loan arranged in 2011 that fell due in 2016). The loan falls due in 2021 and the average interest rate for the period was 2.48% (4.01% in 2015). This item also includes the current credit facility arranged with REE for an amount of Euros 650 million (Euros 650 million in 2015). Euros 528,524 thousand had been drawn down at 31 December 2016 (Euros 513,038 thousand at 31 December 2015). The average interest rate for the period was 0.36% (0.67% in 2015).

Loans and dividends receivable from REINTEL primarily include the loan originally arranged with REI in 2014, which was assumed by REINTEL on 1 July 2015 (see note 8). The loan amounts to Euros 133 million at 31 December 2016 (Euros 168 million at 31 December 2015) and falls due in 2022. The average interest rate for the period was 3.77% (3.80% in 2015).

Loans receivable from RECH in 2016 essentially include the US Dollars 150 million loan arranged with this company on 25 January 2016, which falls due in 2021 and had been fully drawn down at 31 December 2016 (Euros 142,301 thousand). The average interest rate for the period was 2.60%. With a view to reducing the currency risk on this US Dollar loan, the Company has arranged US Dollar/Euro cross currency swaps on the principal and interest (see note 11).

A current credit facility was also extended to RECH in 2016 totalling US Dollars 200 million, which was fully repaid on 20 December 2016. The average interest rate for the period was 3.04%.

Transactions with Group companies and associates are as follows (in thousands of Euros):

	2016				2015			
	Other operating income	Finance income	Other expenses	Finance costs	Other operating income	Finance income	Other expenses	Finance costs
Red Eléctrica de España, S.A.U. (REE)	9,928	545,451	1,080	-	9,933	496,385	1,080	-
Red Eléctrica Internacional, S.A. (REI)	36	-	-	-	9	-	-	-
Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (REINTEL)	240	5,668	-	-	257	6,575	-	-
Red Eléctrica de España Finance, B.V. (RBV)	-	214	-	-	-	213	-	-
Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN)	12	-	-	-	-	-	-	-
Red Eléctrica Chile SpA (RECH)	-	6,515	-	-	-	-	-	-
	--------------	---------------	------------	------------	------------	------------	------------	------------
Total Group companies	10,216	557,848	1,080	-	10,199	503,173	1,080	-
	==========	==========	==========	==========	==========	==========	==========	==========

At 31 December 2016 and 2015 other operating income from REE, REINTEL and REI mainly derives from the property lease agreements entered into with these companies.

In 2016 and 2015 finance income primarily reflects the dividends received from REE and RBV, and interest earned on the loans and credit facilities extended to REE, REINTEL and RECH (REE and REINTEL in 2015).

Related party balances and transactions

Related party transactions are carried out under normal market conditions and their amounts are immaterial. Details in thousands of Euros are as follows:

	2016				2015			
	Significant shareholders	Management	Other related parties	Total	Significant shareholders	Management	Other related parties	Total
Other expenses	-	-	47	47	-	-	-	-
	-------	-------	-------	-------	-------	-------	-------	-------
Total expenses	-	-	47	47	-	-	-	-
	=====	=====	=====	=====	=====	=====	=====	=====
Other income	-	-	66	66	-	-	2	2
	-------	-------	-------	-------	-------	-------	-------	-------
Total income	-	-	66	66	-	-	2	2
	=====	=====	=====	=====	=====	=====	=====	=====
Other transactions	-	-	-	-	-	-	-	-
	-------	-------	-------	-------	-------	-------	-------	-------
Total other transactions	-	-	-	-	-	-	-	-
	=====	=====	=====	=====	=====	=====	=====	=====

Balances with related parties are not material. Details, in thousands of Euros, are as follows:

	2016				2015			
	Significant shareholders	Management	Other related parties	Total	Significant shareholders	Management	Other related parties	Total
Receivables	-	-	66	66	-	-	-	-
Payables	-	-	-	-	-	-	-	-
	----------	----------	----------	----------	----------	----------	----------	----------
Total balance	-	-	66	66	-	-	-	-
	=======	=======	=======	=======	=======	=======	=======	=======

The balance shown under other related parties in 2016 mainly comprises investments in EIGs, and insurance and reinsurance transactions.

23. REMUNERATION OF THE BOARD OF DIRECTORS

At their meeting on 23 February 2016, the Company's directors approved the remuneration of the board of directors for 2016, as required by the articles of association and the regulations of the board of directors, based on a proposal from the Appointments and Remuneration Committee. Both the remuneration policy for directors and the annual remuneration report were subsequently submitted for the approval of the shareholders at their general meeting on 15 April 2016.

Until 17 July 2015, the Company's chairman was both its chief executive and chairman of the board of directors. At the chairman's proposal, the board of directors resolved to propose to the shareholders at their general meeting that the two positions be segregated.

On 17 July 2015, at their extraordinary general meeting, the shareholders approved the appointment of Mr. Juan Lasala Bernad as executive director of the Company for a period of four years, as stipulated in the articles of association. As a result of this appointment, the number of board members increased to 12. This is within the limit established in article 20 of the Company's articles of association, which stipulates a minimum of 9 and a maximum of 13 board members.

At its meeting on 28 July 2015, the board of directors unanimously approved the appointment and agreed to jointly and unselectively delegate thereto all of the board of directors' powers that may be delegated pursuant to the law and the articles of association.

The variation in total remuneration of the board of directors from 2015 to 2016 is almost entirely explained by the appointment of the managing director and the transfer of duties undertaken in accordance with the remuneration policy approved by the shareholders at the general meetings in July 2015 and April 2016, as mentioned above. The remuneration of the other members of the board of directors was identical in all items and amounts in 2016 and 2015.

For the purpose of disclosing the remuneration of the chairman and that of the managing director, 2016 was divided into two periods based on certain corporate milestones linked to the gradual transfer of executive duties from the former to the latter, culminating in the complete transfer of those duties at the ordinary general shareholders meeting on 15 April 2016:

- From 1 January 2016 to the date of the ordinary general shareholders meeting, whereupon the transitional period for the transfer of all executive duties to the managing director ended. The remuneration policy for this period followed the principles and criteria set forth in the remuneration policy for directors approved by the shareholders at their ordinary general meeting in 2015, and observed the agreements adopted by the shareholders at their extraordinary general meeting in 2015.

- The chairman of the board of directors ceased performing executive duties as of the date of the ordinary general shareholders meeting in 2016, and since that date all executive duties have been performed by the managing director. During this period the remuneration policy was adapted to the criteria approved by the shareholders at their general meeting in 2016.

Since 15 April 2016, the date of the general shareholders meeting, the chairman's remuneration has comprised a fixed annual amount for his duties as the Company's non-executive chairman, and the aforementioned remuneration as a member of the board of directors. Both remuneration components are under the same terms as in 2015. From that date onwards, the remuneration scheme for this position consists solely of fixed components, with no annual or multi-year variable remuneration.

The chairman's contract was proposed by the Corporate Responsibility and Governance Committee (currently the Appointments and Remuneration Committee) and approved by the Company's board of directors in March 2012. At the proposal of the Appointments and Remuneration Committee, and with the approval of the board of directors on 23 February 2016, this contract was amended to reflect the new conditions as non-executive chairman of the Company. Furthermore, at the end of the transitional period as executive chairman, the chairman had accrued an indemnity corresponding to one year's remuneration as executive chairman, as stipulated in the contract. This indemnity will be payable once the chairman ceases to be a board member of the Company.

Since the general shareholders meeting, the remuneration of the managing director has also been reviewed, such that it is commensurate with having assumed all executive duties of the Company, as approved by the shareholders at their general meetings on 17 July 2015 and 15 April 2016. The managing director's remuneration includes the fixed and variable annual and multi-year components corresponding to executive duties and the fixed remuneration for being a member of the board of directors. Employee benefits will continue to form part of the remuneration for this position.

The managing director's contract was proposed by the Appointments and Remuneration Committee and approved by the Company's board of directors on 28 July 2015. At the proposal of the Appointments and Remuneration Committee, and with the approval of the board of directors on 23 February 2016, this contract was amended, in accordance with the remunerations policy, to reflect the new conditions after taking on all executive duties.

Pursuant to the remunerations policy and in line with standard market practices, this contract provides for termination benefits equal to one year's salary in the event that labour relations are terminated due to dismissal or changes of control. In addition, as is customary in such cases, as a result of this appointment as managing director, the existing employment contract has been suspended. Should the employment contract be terminated, he would accrue the remuneration due at the date of suspension as an indemnity. For this purpose, his tenure at the Company on the date he was appointed managing director (14 years) would be taken into consideration, in accordance with prevailing employment legislation.

Annual variable remuneration is set by the Appointments and Remuneration Committee of the Company at the start of each year, using predetermined quantifiable and objective criteria. The targets are in line with the strategies and actions established in the Company's strategic plan and the degree of compliance is assessed by the Committee.

The remuneration of the board of directors includes fixed annual remuneration, allowances for attending board meetings, remuneration for work on the board of directors' committees and specific annual remuneration both for the chairs of the committees and the coordinating independent director.

The total amounts accrued by the members of the Company's board of directors in 2016 and 2015 are as follows:

		2016	2015
Total remuneration of the board of directors		2,341	1,916
Directors' remuneration in respect of executive duties[(1)]		802	737
		---------	---------
	Total	3,143	2,653
		======	======

(1) This includes fixed and variable annual remuneration accrued during the year. In 2016 this includes the chairman and the managing director from 1 January 2016 to 15 April 2016, and just the managing director thereafter.

The rise in total remuneration of the board of directors compared with the prior year is basically due to the managing director being considered as a board member for the whole of 2016 (only from 17 July 2015 onwards in 2015). The increase is also attributable to the inclusion of new members of the Audit Committee and the Appointments and Remuneration Committee at the end of 2015, as well as the inclusion from 15 April 2016 onwards of the chairman's fixed remuneration in a non-executive role, forgoing any variable remuneration.

The increase in directors' remuneration in respect of executive duties compared with the prior year is essentially due to the aforementioned segregation of duties, which entails the inclusion in 2016 of the managing director's remuneration as chief executive of the Company and the coexistence of the positions of executive chairman and managing director up to the date of the 2016 general shareholders meeting.

A breakdown of this remuneration by type of director at 31 December 2016 and 2015, in thousands of Euros, is as follows:

	2016		2015
Type of director:			
Executive directors	992	(1)	951
External proprietary directors	524		488
External independent directors	1,238		1,214
Other external directors	389	(2)	0
	---------		---------
Total remuneration	3,143		2,653
	======		======

(1) This includes the total remuneration of the managing director in 2016 and the total remuneration of the chairman as chief executive up to 15 April 2016.

(2) This includes the chairman's total remuneration from 15 April 2016 onwards.

The remuneration accrued by individual members of the Company's board of directors in 2016, in thousands of Euros, by components and directors, is as follows:

	Fixed remuneration	Variable remuneration	Allowances for attending board meetings	Committee work	Chairperson of committee or board and coordinating independent director	Other remuneration [5]	Total 2016	Total 2015
Mr José Folgado Blanco	530	29	16	0	0	0	575	707
Mr Juan Lasala Bernad	483	247	16	0	0	60	806	244
Ms. María de los Angeles Amador Millán	131	0	16	28	0	0	175	162
Mr Fernando Fernández Méndez de Andés	131	0	16	28	0	0	175	175
Ms. Paloma Sendín de Cáceres [1]	38	0	5	8	0	0	51	182
Ms. Carmen Gómez de Barreda	131	0	16	28	15	0	190	190
Ms. María José García Beato	131	0	16	28	0	0	175	175
Ms. Socorro Fernandez Larrea	131	0	16	28	0	0	175	175
Mr Antonio Gómez Ciria	131	0	16	28	0	0	175	175
Mr Santiago Lanzuela Marina	131	0	16	28	0	0	175	150
Mr Agustín Conde Bajén [2]	82	0	9	17	0	0	108	0
Mr Jose Luis Feito Higueruela	131	0	16	28	15	0	190	155
Mr Jose Angel Partearroyo Martin[3]	131	0	16	26	0	0	173	5
Other board members [4]	0	0	0	0	0	0	0	158
	---------	---------	---------	---------	---------	---------	---------	---------
Total remuneration accrued	2,312	276	190	275	30	60	3,143	2,653
	======	======	======	======	======	======	=======	=======

[1] Departure announced at the general shareholders meeting on 15 April 2016.
[2] New director since the general shareholders meeting on 15 April 2016, stepped down from the board of directors on 29 November 2016.
[3] Amounts received by Sociedad Estatal de Participaciones Industriales (SEPI).
[4] Board members in 2015 who have stepped down from the board.
[5] Includes the employee benefits that form part of the managing director's remuneration.

The chairman and managing director are beneficiaries of a life insurance policy with an aggregate annual premium of Euros 12 thousand in 2016 and expiry date on 31 December 2016.

As a result of the work of the Company's Appointments and Remuneration Committee on various long-term incentive plans to be used as a management tool and mechanism for compliance with the new Strategic Plan, in 2015 the Committee approved a directors' remuneration scheme for 2014-2019. This scheme includes the chairman and managing director, although in the case of the chairman the remuneration is only applicable up to 28 July 2015, the date on which the managing director was appointed. As the chairman was no longer included in this scheme, in 2016 he was paid Euros 188 thousand for the period it was applicable and no further amounts were accrued in this respect from the aforementioned date onwards.

Fulfilment of this remuneration scheme, which forms part of the remuneration policy, will be based on achieving the targets set out in the Group's Strategic Plan for this period and on meeting certain conditions. A minimum limit of 70% and maximum limit of 110% is established for evaluation of this scheme. Depending on the targets met, the total amount for the six-year period with 100% compliance would be 1.8 times the annual fixed remuneration. As in the case of annual targets, this scheme takes into account predetermined quantifiable and objective criteria, in line with the medium- and long-term outlook of the Group's strategic plan. These targets are set and assessed by the Appointments and Remuneration Committee. The Company's financial statements include a provision for accrual of this plan in 2016.

At 31 December 2016 and 2015 no loans or advances have been granted to the members of the board of directors, nor have any guarantees been pledged on their behalf. The Company has no pension or life insurance obligations with the members of the board of directors at those dates, other than those previously mentioned, nor have any loans or advances been extended to board members.

At 31 December 2016 and 2015 the Company has taken out civil liability insurance to cover claims from third parties in respect of possible damage or loss caused by actions or omissions in performing duties as Company directors. These policies cover the Company's directors and senior management and the premiums amount to Euros 62 thousand, inclusive of tax, in 2016 (Euros 62 thousand at 31 December 2015). These premiums are calculated based on the nature of the Company's activity and its financial indicators, thus they cannot be broken down individually or allocated to directors and senior management separately.

In 2016 and 2015 the members of the board of directors did not engage in transactions with the Company, either directly or through intermediaries, other than ordinary operations under market conditions.

24. REMUNERATION OF SENIOR MANAGEMENT

At 31 December 2016 the Company has no senior management personnel besides the managing director.

25. SEGMENT REPORTING

The Company does not consider it relevant to disclose the distribution of revenue by category of activity, insofar as these categories are not structured very differently in terms of the rendering of services as part of the Company's ordinary activities. Following the contribution of the branch of activities in 2008 pursuant to Law 17/2007, these activities are not regulated electricity activities. As such, the Company is not subject to the requirement to give separate disclosures by activity provided for in Royal Decree 437/1998 of 20 March 1998, which approves the standards adapting the Spanish General Chart of Accounts to electricity sector companies.

26. GUARANTEES AND OTHER COMMITMENTS WITH THIRD PARTIES AND OTHER CONTINGENT LIABILITIES

At 31 December 2016 and 2015 the Company, together with REE, has jointly and severally guaranteed the private issue in the United States of bonds totalling US Dollars 430 million by the Group company RBV, and REF's Eurobonds programme for an amount of up to Euros 4,500 million.

Furthermore, at 31 December 2016 and 2015 the Company and REE have jointly and severally guaranteed the Euro Commercial Paper Programme (ECP Programme) carried out by REF for an amount of up to Euros 1,000 million.

In 2016 the Company fulfilled its commitment undertaken at 31 December 2015 to invest Euros 3,600 thousand in a property in Tenerife (see note 5).

At 31 December 2016 the Company has extended bank guarantees to third parties in an amount of Euros 1 thousand (Euros 57 thousand in 2015).

27. ENVIRONMENTAL INFORMATION

At 31 December 2016 and 2015 the Company has no assets for the protection and improvement of the environment, nor has it incurred any environmental costs during the year.

The Company is not involved in any litigation relating to environmental protection or improvement that could give rise to significant contingencies. No environment-related grants were received in the year.

28. OTHER INFORMATION

KPMG Auditores, S.L. is the auditor of the Company’s accounts for 2016 and 2015. The total fee accrued for audit services rendered to the Company in 2016 is Euros 77 thousand (Euros 77 thousand in 2015). Furthermore, in 2016 other companies directly or indirectly related to the auditor accrued fees of Euros 15 thousand for audit-related services (Euros 15 thousand in 2015).

29. SHARE-BASED PAYMENT

No Company shares were delivered to employees in 2016. In 2015, a total of 152 shares were delivered (before the Company's share split took place, see note 14-b) with a fair value of Euros 78.88 each, resulting in an expense for the year of Euros 12 thousand.

This remuneration is measured based on the quotation of these Company shares on the day they were delivered.

The shares delivered were approved by the Company's shareholders at their general meeting, and the related costs incurred have been recognised under personnel expenses in the income statement.

30. EVENTS AFTER 31 DECEMBER 2016

On 19 January 2017 the Group company REI acquired 45% of the shares in REDESUR from the infrastructure investment fund AC Capitales. REI thereby increased its ownership of this Peruvian company to 100%.

The effective date of this acquisition is 1 January 2017.

RED
ELÉCTRICA
CORPORACIÓN

Directors' Report 2016

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

Contents

1. BUSINESS PERFORMANCE MOST SIGNIFICANT EVENTS

Since July 2008, Red Eléctrica Corporación, S.A. (hereinafter REC) has been operating as the Parent of the Red Eléctrica Group by holding equity investments in the Group companies and rendering assistance and support services to these companies.

The commitments that the Company undertakes in carrying out these activities drive it towards the ongoing generation of value for its shareholders and stakeholders.

2. KEY FINANCIAL INDICATORS

In 2016, the Company posted profit after tax of Euros 551.8 million, an increase of 10.3% compared to 2015. Details of the key components are as follows:

- Revenue amounted to Euros 557.8 million, up 9.8% on 2015. This figure includes Euros 534 million of dividends from Group companies, given that one of the Company's activities as Parent of the Group is holding shares in Group companies.

- EBITDA totalled Euros 560.6 million, climbing 10.3% vis-à-vis 2015.

- EBIT amounted to Euros 558.9 million, up 10.3% on 2015.

The dividends paid in 2016 amounted to Euros 432.8 million, which is 7% more than in 2015.

REC's equity was Euros 2,393.2 million, up 4.8% on 2015.

3. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS

All of the shares in REC, the Group's listed company, are quoted on the four Spanish stock exchanges and are traded through the Spanish automated quotation system. REC also forms part of the IBEX 35 index, of which it represented 2.0% at the end of 2016.

At 31 December 2016, the share capital of REC amounted to Euros 270.5 million and was represented by 541,080,000 shares with a par value of Euros 0.50 each, subscribed and fully paid. At the 2016 annual general meeting, the shareholders approved a 4-for-1 share split, reducing the par value of the Company's shares from Euros 2 to Euros 0.50 per share without modifying total share capital.

During the year REC's free float was 80%.

At the date of the last shareholders' meeting – 15 April 2016 – the free float comprised 432,864,000 shares, of which an estimated 13% is held by non-controlling shareholders, 5% by Spanish institutional investors and 82% by foreign institutional investors, primarily in the United Kingdom and the United States.

In terms of stock market performance, once again the United States top the rankings with double-digit improvement. The Dow Jones was the strongest of the principal US indices, closing the year with a rise of 13%, followed by S&P 500, up 10%, and Nasdaq, which climbed 8%.

Performance was more subdued in Europe, however. London's FTSE 100 displayed the most notable performance, rising 14%. The other European stock markets ended the year in positive figures (Paris +5%, Frankfurt +7%), except the Italian stock exchange which closed at a loss (down 10%), hindered by the weakness of its financial system, and the Spanish selective index, which slid 2%.

The listed price of REC's shares dropped 2% in 2016, despite its well-received 2014-2019 Strategic Plan presented in February, with challenging targets and competitive dividends as its main features.

The market capitalisation of the Company at the end of 2016 was Euros 9,730 million.

In total, 714.4 million shares were traded in 2016, which is 1.32 times the Company's share capital. In cash terms, Euros 13,432 million was traded, down 28% on the Euros 18,537 million traded in the prior year.

4. OWN SHARES

In order to provide investors with adequate levels of liquidity the Company acquired 5,003,630 shares with a total par value of Euros 2.5 million and a cash value of Euros 93.9 million in 2016. A total of 4,786,046 shares were sold, with an overall par value of Euros 2.4 million and a cash value of Euros 90.9 million.

At 31 December 2016 the Company held 1,966,332 own shares, representing 0.36% of its share capital. These shares had an overall par value of Euros 983 thousand (see note 14 to the annual accounts) and a market value of Euros 35,247 thousand.

The Company has complied with the requirements of article 509 of the Spanish Companies Act, which provides that the par value of acquired shares listed on secondary markets, together with those already held by the Company and its subsidiaries, must not exceed 10% of the share capital. The Company's subsidiaries do not hold own shares or shares in the Company.

5. RISK MANAGEMENT

The Group has implemented a Comprehensive Risk Management System, which aims to ensure that any risks that might affect its strategies and objectives are systematically identified, analysed, assessed, managed and controlled, according to uniform criteria and within the established risk levels, in order to facilitate compliance with the strategies and objectives of the Group. The Comprehensive Risk Management Policy was approved by the board of directors. This Comprehensive Risk Management System, the Policy and the General Procedure are based on the COSO II (Committee of Sponsoring Organizations of the Treadway Commission) Enterprise Risk Management Integrated Framework.

The main risk identified as regards REC achieving its objectives is credit risk, inasmuch as debt transactions are carried out through Group companies, which assume the market, liquidity, regulatory, operational and environmental risks associated with the Group's activities.

The risk management policies are detailed in note 9 to the accompanying annual accounts.

6. ENVIRONMENT

At 31 December 2016, REC has no assets for the protection and improvement of the environment. In 2016 the Company incurred no expenses in protecting and improving the environment.

REC is not involved in any litigation relating to environmental protection or improvement that could give rise to significant contingencies. No environment-related grants were received in the year.

7. RESEARCH, DEVELOPMENT AND INNOVATION (R&D&i)

REC does not carry out research, development or innovation activities (R&D&i).

8. EXCELLENCE AND CORPORATE RESPONSIBILITY

Corporate responsibility forms part of the Red Eléctrica Group's corporate culture. It is also a key tool for creating value when conducting its activities to fulfil its mission.

As a key line of action for the Group, the 2014-2019 Strategic Plan lays down a management process based on corporate responsibility best practice. In implementing this strategy, the Group acts in a responsible, ethical and committed manner vis-à-vis its stakeholders and society in general.

The Group's commitment to developing a sustainable future for energy is embodied in the principles and guidelines contained in its Corporate Responsibility Policy, and brought into effect through a multi-year plan that defines the medium-term initiatives framework for its corporate responsibility.

The Group forms part of the most reputable sustainability indices, demonstrating its commitment to sustainability, which in turn serves as a pivotal tool for addressing global challenges, and reflecting its bid for transparency in its reporting to third parties. The performance of the Group is subject to ongoing analysis and assessment. The Group's presence in the principal sustainability indices (Dow Jones Sustainability Indices, FTSE4Good, Climate Disclosure Project, Euronext Vigeo, Ethibel, MSCI, Stoxx Global ESG Leaders Indices and ECPI) evidences its firm commitment to sustainable development.

Since 1999, the Company has applied the EFQM (European Foundation for Quality Management) Excellence Model, aiming for ongoing improvements to the Company's management and results. A certified system (quality, environment, occupational health and safety, corporate responsibility and energy efficiency) subject to annual audit has been in place since 2000, covering all of the Company's processes.

In 2016 the Group retained its European Seal of Excellence 500+, which was renewed in 2015, with a rating of 700 to 750 points, as awarded by Club Excelencia en Gestión (CEG), the official representative in Spain of the European Foundation for Quality Management. The 2016-2017 Excellence Plan was drawn up in 2016, containing 46 improvement initiatives arising from the report on the analysis of excellence conducted in 2015.

An analysis was carried out in 2016 of Red Eléctrica's existing alliances, linking these with the Strategic Plan and the stakeholders. After clearly defining the meaning of an alliance for Red Eléctrica, and having analysed and classified the existing alliances, this work serves as a starting point for identifying opportunities to create shared value with the stakeholders.

The excellence management system is in turn based on a process management approach. In this respect, risk management at process level was introduced in 2016, thereby extending the scope of the Company's risk management.

9. AVERAGE SUPPLIER PAYMENT PERIOD "“REPORTING REQUIREMENT", THIRD ADDITIONAL PROVISION OF LAW 15/2010 OF 5 JULY 2010

In accordance with the Spanish Accounting and Auditing Institute (ICAC) resolution of 29 January 2016 regarding the information that must be disclosed in the notes to annual accounts on average payment periods to suppliers in commercial transactions, the average supplier payment period was 38.6 days at the 2016 year end.

The disclosures required by this resolution are contained in note 20 to the Company's annual accounts for 2016.

10. SIGNIFICANT EVENTS OCCURRING AFTER THE REPORTING PERIOD

On 19 January 2017 the Group company Red Eléctrica Internacional (hereinafter REI) acquired 45% of the shares in REDESUR, which until then were held by the infrastructure investment fund AC Capitales. REI thereby increased its ownership of this Peruvian company to 100%.

The effective date of this acquisition is 1 January 2017.

11. DIVIDEND POLICY

The dividends paid in 2016 amounted to Euros 432.8 million, 7% more than in 2015.

The board of directors has proposed a dividend of Euros 0.8587 per share with a charge to 2016 profit, pending approval by the shareholders at their general meeting, representing a year-on-year increase of 7%. This takes into account the new number of Company shares (541,080,000 shares as opposed to 135,270,000 shares previously).

Based on the projections and estimates contained in the Group's 2014-2019 Strategic Plan, the dividend could grow at a rate of approximately 7%. This increase is considered as the average annual rate for the period covered by the Strategic Plan, on the basis of the total dividend approved with a charge to 2014. This forecast is subject to fulfilment of the Plan.

The dividend will be paid in two instalments – an interim dividend in January and a supplementary dividend half way through the year following approval of the annual accounts by the shareholders at their general meeting.

12. OUTLOOK

As head of the Red Eléctrica Group, REC will keep working towards achieving the objectives laid out in the Strategic Plan. To this end, it will continue in its role of Spanish TSO, while also reinforcing its efficiency criteria so as to adapt to the new, more stringent regulatory and remuneration environment, and placing greater emphasis on widening its business base as an alternative means of growth.

Implementation of the strategy, based on excellence, innovation and personal development, will allow the Group to maintain its current leadership in terms of the reliability and security of the electricity systems it operates and the excellent standards in other activities.

REC will uphold its commitment to maximise value for its shareholders, offering an attractive return in the form of dividends and generating value through efficient management of its activities, analysing alternatives for expanding its business base, maintaining a robust capital structure and working to guarantee supply with a maximum level of quality.

The Group will therefore continue to seek the generation of long-term value, creating lasting, competitive advantages and improving our corporate reputation, whilst focusing on providing optimum service to society – the differentiating feature of the Group's management.

13. ANNUAL CORPORATE GOVERNANCE REPORT

The Annual Corporate Governance Report forms an integral part of the Directors' Report and can be viewed at the following address:

http://www.cnmv.es/Portal/consultas/EE/InformacionGobCorp.aspx?nif=A-78003662

The various sections of this director's report contain certain prospective information that reflects projections and estimates based on underlying assumptions, statements referring to plans, objectives and expectations associated with future transactions, investments, synergies, products and services, as well as statements concerning results or future dividends, or estimates calculated by the directors and based on assumptions that those directors consider reasonable.

While the Company considers the expectations reflected in those statements to be reasonable, investors and holders of shares in the Company are advised that the information and statements containing future projections are subject to risks and uncertainties, many of which are difficult to foresee and generally beyond the Company's control. As a result of such risks, actual results and developments could differ substantially from those expressed, implied or forecast in the information and statements containing future projections.

The affirmations and statements containing future projections do not provide any guarantee as to future results and have not been reviewed by auditors outside the Company or by other independent third parties. It is recommended that no decisions be made on the basis of the affirmations and statements containing future projections that refer exclusively to the information available at the date of this report. All of the affirmations and statements containing future projections that are reflected in this report are expressly subject to the warnings given. The affirmations and statements containing future projections included in this document are based on the information available at the date of this directors' report. Except as required by applicable legislation, the Company is not obligated to publicly update its statements or review the information containing future projections, even where new data is published or new events arise