

Red Eléctrica Corporación, S.A. and Subsidiaries

Consolidated Annual Accounts

31 December 2016

Consolidated 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 Consolidated 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 Consolidated Annual Accounts

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

Directors' Responsibility for the Consolidated Annual Accounts

The Directors are responsible for the preparation of the accompanying consolidated annual accounts in such a way that they give a true and fair view of the consolidated equity, consolidated financial position and consolidated financial performance of Red Eléctrica Corporación, S.A. and subsidiaries in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control that they determine is necessary to enable the preparation of consolidated 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 consolidated 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 consolidated annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Directors' preparation of the consolidated 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 consolidated 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 consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of Red Eléctrica Corporación, S.A. and subsidiaries at 31 December 2016 and of their consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the financial reporting framework applicable in Spain.

Report on Other Legal and Regulatory Requirements

The accompanying consolidated directors' report for 2016 contains such explanations as the Directors of Red Eléctrica Corporación, S.A. consider relevant to the situation of the Group, its business performance and other matters, and is not an integral part of the consolidated annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the consolidated annual accounts for 2016. Our work as auditors is limited to the verification of the consolidated 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 Red Eléctrica Corporación, S.A. and subsidiaries.

KPMG Auditores, S.L.

(Signed on original in Spanish)

Ana Fernández Poderós

23 February 2017



RED ELÉCTRICA GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
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.)

ASSETS	31/12/2016	31/12/2015
Intangible assets (note 5)	134.572	118.471
Property, plant and equipment (note 6)	8.776.711	8.884.598
Investment property (note 7)	2.429	2.473
Equity-accounted investees (note 8)	200.757	-
Non-current financial assets (note 16)	111.861	119.986
Deferred tax assets (note 20)	28.903	30.111
Other non-current assets	1.532	902
NON-CURRENT ASSETS	9.256.765	9.156.541
Inventories (note 9)	39.467	41.755
Trade and other receivables (note 10)	962.122	1.010.265
Trade receivables	15.052	14.023
Other receivables	943.376	993.784
Current tax assets	3.694	2.458
Other current financial assets (note 16)	40.575	2.522
Cash and cash equivalents	251.421	386.861
CURRENT ASSETS	1.293.585	1.441.403
TOTAL ASSETS	10.550.350	10.597.944
EQUITY AND LIABILITIES	31/12/2016	31/12/2015
Capital and reserves	2.965.210	2.774.745
Capital	270.540	270.540
Reserves	2.222.906	2.051.350
Own shares (-)	(36.739)	(33.076)
Profit attributable to the Parent	636.920	606.013
Interim dividend (-)	(128.417)	(120.082)
Valuation adjustments	(62.156)	(29.482)
Available-for-sale financial assets	16.125	15.480
Hedging transactions	(83.801)	(48.613)
Translation differences and other	5.520	3.651
EQUITY ATTRIBUTABLE TO THE PARENT	2.903.054	2.745.263
Non-controlling interests	17.495	15.350
TOTAL EQUITY (note 11)	2.920.549	2.760.613
Grants and other (note 12)	547.941	548.598
Non-current provisions (note 13)	94.651	84.528
Non-current financial liabilities (note 16)	5.034.400	4.827.113
Loans and borrowings, bonds and other marketable securities	4.960.556	4.770.841
Other non-current financial liabilities	73.844	56.272
Deferred tax liabilities (note 20)	486.570	512.286
Other non-current liabilities (note 14)	64.225	68.196
NON-CURRENT LIABILITIES	6.227.787	6.040.721
Current financial liabilities (note 16)	1.066.909	1.313.328
Loans and borrowings, bonds and other marketable securities	384.044	648.156
Other current financial liabilities	682.865	665.172
Trade and other payables (note 18)	335.105	483.282
Suppliers	301.272	402.334
Other payables	19.787	74.672
Current tax liabilities	14.046	6.276
CURRENT LIABILITIES	1.402.014	1.796.610
TOTAL EQUITY AND LIABILITIES	10.550.350	10.597.944

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP
CONSOLIDATED INCOME STATEMENT
2016 and 2015
IN THOUSANDS OF EUROS

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

CONSOLIDATED INCOME STATEMENT	2016	2015
Revenue (note 21-a)	1.932.343	1.938.939
Self-constructed assets	40.398	20.719
Supplies (note 21-b)	(49.222)	(47.865)
Other operating income	21.264	12.506
Personnel expenses (note 21-c)	(145.145)	(139.635)
Other operating expenses (note 21-b)	(313.589)	(326.237)
Depreciation and amortisation (notes 5, 6 and 7)	(504.200)	(489.533)
Non-financial and other capital grants (note 12)	21.318	20.084
Impairment and gains/(losses) on disposal of fixed assets (note 6)	121	40
RESULTS FROM OPERATING ACTIVITIES	1.003.288	989.018
Finance income (note 21-d)	10.970	8.932
Finance costs (note 21-d)	(162.003)	(167.457)
Exchange losses	(313)	(41)
Impairment and gains/(losses) on disposal of financial instruments (note 21-e)	-	(730)
NET FINANCE COST	(151.346)	(159.296)
Share in profit/(loss) of equity-accounted investees (note 8)	(1.154)	-
PROFIT BEFORE INCOME TAX	850.788	829.722
Income tax (note 20)	(212.181)	(222.962)
CONSOLIDATED PROFIT FOR THE YEAR	638.607	606.760
A) CONSOLIDATED PROFIT FOR THE YEAR ATTRIBUTABLE TO THE PARENT	636.920	606.013
B) PROFIT FOR THE YEAR ATTRIBUTABLE TO NON-CONTROLLING INTERESTS	1.687	747
EARNINGS PER SHARE IN EUROS		
Basic earnings per share in Euros (note 30) (*)	1,18	1,12
Diluted earnings per share in Euros (note 30) (*)	1,18	1,12

(*) In 2016 a share split was performed resulting in four new shares per each old share. For comparison purposes, the 2015 figure shows the earnings per share if this share split had been performed in 2015.

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP
 CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
 2016 and 2015
 IN THOUSANDS OF EUROS

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME	2016	2015
A) CONSOLIDATED PROFIT FOR THE YEAR	638.607	606.760
B) OTHER COMPREHENSIVE INCOME - ITEMS THAT WILL NOT BE RECLASSIFIED TO PROFIT OR LOSS:	(1.592)	12.182
1. Revaluation/(reversal) of PPE and intangible assets	-	-
2. Actuarial gains and losses	(2.123)	16.242
3. Share in other comprehensive income from investments in joint ventures and associates	-	-
4. Other income and expense that will not be reclassified to profit or loss	-	-
5. Tax effect	531	(4.060)
C) OTHER COMPREHENSIVE INCOME - ITEMS THAT COULD SUBSEQUENTLY BE RECLASSIFIED TO PROFIT OR LOSS:	(32.215)	32.233
1. Available-for-sale financial assets:	(2.242)	10.039
a) Revaluation gains/(losses)	(2.242)	10.039
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
2. Cash flow hedges:	(39.902)	28.428
a) Revaluation gains/(losses)	(41.082)	27.526
b) Amounts transferred to the income statement	1.180	902
c) Amounts transferred to initial value of hedged items	-	-
d) Other reclassifications	-	-
3. Translation differences:	3.103	5.389
a) Revaluation gains/(losses)	3.103	5.389
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
4. Share in other comprehensive income from investments in joint ventures and associates	(5.263)	-
a) Revaluation gains/(losses)	(5.263)	-
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
5. Other income and expense that could subsequently be reclassified to profit or loss	-	-
a) Revaluation gains/(losses)	-	-
b) Amounts transferred to the income statement	-	-
c) Other reclassifications	-	-
6. Tax effect	12.089	(11.623)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR (A + B + C)	604.800	651.175
a) Attributable to the Parent	602.655	648.608
b) Attributable to non-controlling interests	2.145	2.567

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP
CONSOLIDATED STATEMENT OF 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.)

EQUITY	Current period								
	Equity attributable to the Parent							Non-controlling interests	Total equity
	Subscribed capital	Reserves	Interim dividend	Own shares	Profit attributable to the Parent	Valuation adjustments	Equity attributable to the Parent		
Balances at 1 January 2016	270.540	2.051.350	(120.082)	(33.076)	606.013	(29.482)	2.745.263	15.350	2.760.613
I. Comprehensive income for the year	-	(1.591)	-	-	636.920	(32.674)	602.655	2.145	604.800
II. Transactions with shareholders or owners	-	(313.270)	(8.335)	(3.663)	(120.082)	-	(445.350)	-	(445.350)
- Distribution of dividends (note 11)	-	(313.745)	(8.335)	-	(120.082)	-	(442.162)	-	(442.162)
- Transactions with own shares (note 11)	-	475	-	(3.663)	-	-	(3.188)	-	(3.188)
III. Other changes in equity	-	486.417	-	-	(485.931)	-	486	-	486
- Transfers between equity line items	-	485.931	-	-	(485.931)	-	-	-	-
- Other changes	-	486	-	-	-	-	486	-	486
Balances at 31 December 2016	270.540	2.222.906	(128.417)	(36.739)	636.920	(62.156)	2.903.054	17.495	2.920.549
	=====	=====	=====	=====	=====	=====	=====	=====	=====
EQUITY	Prior period								
	Equity attributable to the Parent							Non-controlling interests	Total equity
	Subscribed capital	Reserves	Interim dividend	Own shares	Profit attributable to the Parent	Valuation adjustments	Equity attributable to the Parent		
Balances at 1 January 2015	270.540	1.723.852	(112.463)	(10.390)	717.821	(59.894)	2.529.466	22.986	2.552.452
I. Comprehensive income for the year	-	12.183	-	-	606.013	30.412	648.608	2.567	651.175
II. Transactions with shareholders or owners	-	2.890	(7.619)	(22.686)	(405.687)	-	(433.102)	(853)	(433.955)
- Distribution of dividends (note 11)	-	-	(7.619)	-	(405.687)	-	(413.306)	(853)	(414.159)
- Transactions with own shares (note 11)	-	2.890	-	(22.686)	-	-	(19.796)	-	(19.796)
III. Other changes in equity	-	312.425	-	-	(312.134)	-	291	(9.350)	(9.059)
- Transfers between equity line items	-	312.134	-	-	(312.134)	-	-	-	-
- Other changes	-	291	-	-	-	-	291	(9.350)	(9.059)
Balances at 31 December 2015	270.540	2.051.350	(120.082)	(33.076)	606.013	(29.482)	2.745.263	15.350	2.760.613
	=====	=====	=====	=====	=====	=====	=====	=====	=====

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED ELÉCTRICA GROUP
CONSOLIDATED STATEMENT OF CASH FLOWS
2016 and 2015
IN THOUSANDS OF EUROS

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

CONSOLIDATED STATEMENT OF CASH FLOWS	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES	1.007.130	1.326.140
Profit before tax	850.788	829.722
Adjustments for:	647.262	639.039
Depreciation and amortisation (notes 5, 6 and 7)	504.200	489.533
Other adjustments (net)	143.062	149.506
Equity-accounted investees (losses)	1.154	-
(Gains)/losses on disposal/impairment of non-current assets and financial instruments (note 21-f)	(121)	770
Accrued finance income (note 21-e)	(10.970)	(8.932)
Accrued finance costs (note 21-e)	162.003	167.457
Charge to/surplus provisions for liabilities and charges (note 13)	9.013	7.432
Capital and other grants taken to income (note 12)	(18.017)	(17.221)
Changes in operating assets and liabilities	(144.304)	196.879
Changes in inventories, receivables, prepayments for current assets and other current assets	44.624	25.409
Changes in trade payables, current revenue received in advance and other current liabilities	(188.928)	171.470
Other cash flows used in operating activities:	(346.616)	(339.500)
Interest paid	(157.508)	(173.135)
Dividends received (note 21-e)	3.881	4.566
Interest received	6.350	4.366
Income tax paid	(190.351)	(163.112)
Other proceeds from and payments for operating activities	(8.988)	(12.185)
CASH FLOWS USED IN INVESTING ACTIVITIES	(587.605)	(384.257)
Payments for investments	(599.048)	(469.190)
Property, plant and equipment, intangible assets and investment property (notes 5, 6 and 7)	(364.355)	(458.890)
Group companies, associates and business units (note 8)	(200.616)	(10.300)
Other financial assets (note 16)	(34.077)	-
Proceeds from sale of investments	875	3.346
Property, plant and equipment, intangible assets and investment property (notes 5, 6 and 7)	-	59
Other financial assets (note 16)	875	3.287
Other cash flows from investing activities	10.568	81.587
Other proceeds from investing activities (note 12)	10.568	81.587
CASH FLOWS USED IN FINANCING ACTIVITIES	(555.879)	(854.594)
Proceeds from and payments for equity instruments (note 11)	(3.188)	(19.796)
Acquisition	(93.975)	(156.457)
Disposal	90.787	136.661
Proceeds from and payments for financial liability instruments (note 16)	(111.041)	(420.737)
Issue and drawdowns	1.047.939	1.198.485
Redemption and repayment	(1.158.980)	(1.619.222)
Dividends and interest on other equity instruments paid (note 11)	(432.834)	(404.825)
Other cash flows used in financing activities (note 11)	(8.816)	(9.236)
EFFECT OF EXCHANGE RATE FLUCTUATIONS ON CASH AND CASH EQUIVALENTS	914	204
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(135.440)	87.493
Cash and cash equivalents at beginning of year	386.861	299.368
Cash and cash equivalents at year end	251.421	386.861

Notes 1 to 32 and Appendix I form an integral part of these consolidated annual accounts.



RED
ELÉCTRICA
CORPORACIÓN

RED ELÉCTRICA GROUP **Notes to the Consolidated** **Annual Accounts**

2016

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



Contents

1. ACTIVITIES OF THE GROUP COMPANIES.....	8
2. BASIS OF PRESENTATION OF THE CONSOLIDATED ANNUAL ACCOUNTS.....	8
3. INDUSTRY REGULATIONS	15
4. SIGNIFICANT ACCOUNTING PRINCIPLES.....	20
5. INTANGIBLE ASSETS	32
6. PROPERTY, PLANT AND EQUIPMENT	34
7. INVESTMENT PROPERTY	37
8. EQUITY-ACCOUNTED INVESTEEES	37
9. INVENTORIES.....	39
10. TRADE AND OTHER RECEIVABLES	39
11. EQUITY.....	40
12. GRANTS AND OTHER.....	45
13. NON-CURRENT PROVISIONS.....	46
14. OTHER NON-CURRENT LIABILITIES.....	48
15. FINANCIAL RISK MANAGEMENT POLICY	48
16. FINANCIAL ASSETS AND FINANCIAL LIABILITIES.....	51
17. DERIVATIVE FINANCIAL INSTRUMENTS.....	59
18. TRADE AND OTHER PAYABLES.....	62
19. AVERAGE SUPPLIER PAYMENT PERIOD "“REPORTING REQUIREMENT", THIRD ADDITIONAL PROVISION OF LAW 15/2010 OF 5 JULY 2010.....	62
20. TAXATION	63
21. INCOME AND EXPENSES.....	68
22. TRANSACTIONS WITH ASSOCIATES AND RELATED PARTIES	72
23. REMUNERATION OF THE BOARD OF DIRECTORS	74
24. REMUNERATION OF SENIOR MANAGEMENT	78



25. SEGMENT REPORTING.....	80
26. INVESTMENTS IN JOINT ARRANGEMENTS.....	80
27. GUARANTEES AND OTHER COMMITMENTS WITH THIRD PARTIES AND OTHER CONTINGENT ASSETS AND LIABILITIES	80
28. ENVIRONMENTAL INFORMATION	81
29. OTHER INFORMATION	81
30. EARNINGS PER SHARE.....	82
31. SHARE-BASED PAYMENTS	82
32. EVENTS AFTER 31 DECEMBER 2016.....	83
APPENDIX I.....	84



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1. ACTIVITIES OF THE GROUP COMPANIES

Red Eléctrica Corporación, S.A. (hereinafter the Parent or the Company) is the Parent of a Group formed by subsidiaries. The Group is also involved in joint operations along with other operators. The Parent and its subsidiaries form the Red Eléctrica Group (hereinafter the Group or Red Eléctrica Group). The Company's registered office is located in Alcobendas (Madrid) and its shares are traded on the Spanish automated quotation system as part of the selective IBEX-35 index.

The Group's principal activity is electricity transmission, system operation and management of the transmission network for the Spanish electricity system. These regulated activities are carried out through Red Eléctrica de España, S.A.U. (hereinafter REE).

The Group also conducts electricity transmission activities outside Spain through Red Eléctrica Internacional, S.A.U. (hereinafter REI) and its investees, and provides telecommunications services to third parties in Spain through Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (hereinafter REINTEL).

In addition the Group carries out activities through its subsidiaries aimed at financing its operations and covering risks by reinsuring its assets and activities. It also builds electricity infrastructure and facilities through its subsidiaries and/or investees, Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN) and Interconexión Eléctrica Francia-España, S.A.S. (INELFE).

Appendix I provides details of the activities and registered offices of the Parent and its subsidiaries, as well as the direct and indirect investments held by the Parent in the subsidiaries.

2. BASIS OF PRESENTATION OF THE CONSOLIDATED ANNUAL ACCOUNTS

a) General information

The accompanying consolidated annual accounts have been prepared by the directors of the Parent to give a true and fair view of the consolidated equity and consolidated financial position of the Company and its subsidiaries at 31 December 2016, as well as the consolidated results of operations and consolidated cash flows and changes in consolidated equity for the year then ended.

The accompanying consolidated annual accounts, authorised for issue by the Company's directors at their board meeting held on 22 February 2017, have been prepared on the basis of the individual accounting records of the Company and the other Group companies, which together form the Red Eléctrica Group (see Appendix I). Each company prepares its annual accounts applying the accounting principles and criteria in force in its country of operations. Accordingly, the adjustments and reclassifications necessary to harmonise these principles and criteria with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) have been made on consolidation. The accounting policies of the consolidated companies are changed when necessary to ensure their consistency with the principles adopted by the Company.



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

These consolidated annual accounts have been prepared on the historical cost basis, except in the case of available-for-sale financial assets, derivative financial instruments at fair value through profit or loss and business combinations.

The figures disclosed in the consolidated annual accounts are expressed in thousands of Euros, the Parent's functional and presentation currency, rounded off to the nearest thousand. The consolidated annual accounts have been prepared in accordance with IFRS-EU, and other applicable provisions in the financial reporting framework.

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

b) New IFRS-EU and IFRIC

The consolidated annual accounts have been prepared in accordance with IFRS-EU.

The following amendments have been applied for the first time in 2016:

- Annual improvements to International Financial Reporting Standards, Cycle 2012-2014 - mandatory application for all annual periods beginning on or after 1 January 2016.
- Amendments to IFRS 11, Accounting for Acquisitions of Interests in Joint Operations - mandatory application for all annual periods beginning on or after 1 January 2016.
- Amendments to IAS 16 and IAS 38, Clarification of Acceptable Methods of Depreciation and Amortisation. Amendment effective for annual periods beginning on or after 1 January 2016.
- Amendments to IAS 27, Equity Method in Separate Financial Statements. This amendment allows investors to use the equity method in their separate financial statements. This standard is applicable for all annual periods beginning on or after 1 January 2016.
- Amendments to IFRS 10, IFRS 12 and IAS 28, Investment Entities. Clarifications on the consolidation exception for investment entities. Amendments effective for annual periods beginning on or after 1 January 2016.
- Amendments to IAS 1, Disclosure Initiative. Clarifications regarding disclosures (materiality, aggregation of items, order of notes, etc.). This standard is applicable for all annual periods beginning on or after 1 January 2016.
- IAS 19 Employee Benefits - mandatory application for all annual periods beginning on or after 1 February 2015.
- Annual improvements to International Financial Reporting Standards, Cycle 2010-2012 - mandatory application for all annual periods beginning on or after 1 February 2015.



The application of these standards and interpretations did not have a significant impact on these consolidated annual accounts.

The standards approved by the European Union for which application is not mandatory in 2016 are as follows:

- IFRS 9 Financial Instruments. Available standard, pending adoption by the EU. Effective for annual periods beginning on or after 1 January 2018.
- IFRS 15 Revenue from Contracts with Customers. Effective for annual periods beginning on or after 1 January 2018.
- Clarifications to IFRS 15 Revenue from Contracts with Customers. Effective for annual periods beginning on or after 1 January 2018.

The Group is currently analysing the impact of applying these approved standards and amendments for which application is not mandatory in the period ended 31 December 2016. Given the complexity of IFRS 15, IFRS 16 and IFRS 9, this analysis will continue in 2017 and application thereof is not expected to have a material impact on the consolidated annual accounts in the initial application period. As regards the other amendments, the Group considers that their application would not have entailed significant changes in these financial statements and that they will not have a material impact when applied.

At 31 December 2016, the IASB and the IFRS Interpretations Committee had published the following standards, amendments and interpretations, which are pending adoption by the European Union:

- IFRS 16 Leases. Effective for annual periods beginning on or after 1 January 2019.
- Amendments to IAS 28 and IFRS 10 regarding sale or contribution of assets between an investor and its associate or joint venture. Amendments effective for annual periods beginning on or after the date of entry into force, which has not yet been determined.
- Amendments to IAS 12 Income Taxes. Recognition of Deferred Tax Assets for Unrealised Losses. Effective for annual periods beginning on or after 1 January 2017.
- Amendments to IAS 7 Statement of Cash Flows. Disclosure Initiative. Effective for annual periods beginning on or after 1 January 2017.
- Amendments to IFRS 2, Classification and Measurement of Share-Based Payment Transactions. Effective for annual periods beginning on or after 1 January 2018.

The Company is currently analysing the impact that the new standards, amendments and interpretations would have on the Group's consolidated annual accounts, should they be adopted by the European Union. The Company does not expect any major impact from applying these standards.

c) Estimates and assumptions

The preparation of the consolidated annual accounts in accordance with IFRS-EU requires Group 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 judgements are assessed continually and are based on past experience and other factors,



including expectations of future events that are considered reasonable given the circumstances. Actual results could differ from these estimates.

The consolidated annual accounts for 2016 occasionally include estimates calculated by management of the Group and of the consolidated companies, and subsequently endorsed by their directors, to quantify certain assets, liabilities, income, expenses and commitments disclosed therein.

These estimates are essentially as follows:

- Estimated asset recovery, calculated by determining the recoverable amount thereof. The recoverable amount is the higher of fair value less costs to sell and value in use. Asset impairment is generally calculated using discounted cash flows based on financial projections used by the Group. The discount rate applied is the weighted average cost of capital, taking into account the country risk premium (see note 6).
- Estimated useful lives of property, plant and equipment (see note 4.b).
- The assumptions used in the actuarial calculations of liabilities and obligations to employees (see note 13).
- Liabilities are generally recognised when it is probable that an obligation will give rise to an indemnity or a payment. The Group 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 (see note 13).

In the absence of International Financial Reporting Standards (IFRSs) that give guidance on the accounting treatment for a particular situation, in accordance with IAS 8, management uses its best judgement based on the economic substance of the transaction and considering the most recent pronouncements of other standard-setting bodies that use the same conceptual framework as IFRS. Accordingly, as tax credits for investments are not within the scope of IAS 12 and IAS 20, after analysing the related facts and circumstances, Group management has considered that credits for investments granted to the Group by public entities are similar to capital grants. Therefore, in these cases management has taken into account IAS 20 on grants (see note 4j).

To facilitate comprehension of the consolidated 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 consolidated income statement as a change in accounting estimates, as required by IFRS.

d) Consolidation principles

The types of companies included in the consolidated group and the consolidation method used in each case are as follows:



- Subsidiaries

Subsidiaries are entities, including structured entities, over which the Company, either directly or indirectly through subsidiaries, exercises control. The Company controls a subsidiary when it is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. The Company has power over a subsidiary when it has existing substantive rights that give it the ability to direct the relevant activities. The Company is exposed, or has rights, to variable returns from its involvement with the subsidiary when its returns from its involvement have the potential to vary as a result of the subsidiary's performance.

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

The income, expenses and cash flows of subsidiaries are included in the consolidated annual accounts from the date of acquisition, which is when the Group takes control, until the date that control ceases.

Transactions and balances with Group companies and unrealised gains or losses have been eliminated on consolidation. Nevertheless, unrealised losses have been considered as an indicator of impairment of the assets transferred.

- Joint arrangements

Joint arrangements are those in which there is a contractual agreement to share the control over an economic activity, in such a way that decisions about the relevant activities require the unanimous consent of the Group and the remaining venturers or operators. The existence of joint control is assessed considering the definition of control over subsidiaries.

The Group assesses all the facts and circumstances relating to each joint arrangement for the purpose of its classification as a joint venture or joint operation, including whether the arrangement contains rights over the assets and obligations for liabilities.

In joint operations there is a joint arrangement whereby the parties that have joint control have rights to the assets, and obligations for the liabilities, relating to the arrangement. For joint operations, the Group recognises the assets, including its share of any assets held jointly, the liabilities, including its share of any liabilities incurred jointly with the other operators, the revenue from the sale of its share of the output arising from the joint operation, its share of the revenue from the sale of the output by the joint operation and the expenses, including its share of any expenses incurred jointly, in the consolidated annual accounts.

Joint ventures are those in which there is a contractual agreement with a third party to share control over an activity and the strategic financial and operating decisions relating to the activity require the unanimous consent of all the venturers that share control. The Group's interests in jointly controlled entities are accounted for using the equity method in accordance with IFRS 11.



The Group's acquisition of an initial and subsequent share in a joint operation which constitutes a business is recognised following the same criteria used for business combinations, at the percentage of ownership of each individual asset and liability. However, in subsequent acquisitions of additional shares in a joint operation, the previous share in each asset and liability is not subject to revaluation.

In sales or contributions by the Group to the joint operation, it recognises the resulting gains and losses only to the extent of the other parties' interests in the joint operation. When such transactions provide evidence of a reduction in net realisable value or an impairment loss of the assets transferred, such losses are recognised in full.

In purchases by the Group from a joint operation, it only recognises the resulting gains and losses when it resells the acquired assets to a third party. However, when such transactions provide evidence of a reduction in net realisable value or an impairment loss of the assets, the Group recognises its entire share of such losses.

- Associates

Associates are entities over which the Company, either directly or indirectly through subsidiaries, exercises significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The existence of potential voting rights that are exercisable or convertible at the end of each reporting period, including potential voting rights held by the Group or other entities, are considered when assessing whether an entity has significant influence.

Investments in associates are accounted for using the equity method from the date that significant influence commences until the date that significant influence ceases. However, if on the acquisition date all or part of the investment qualifies for recognition as non-current assets or disposal groups held for sale, it is recognised at fair value less costs of disposal.

Investments in associates are initially recognised at cost of acquisition, including any cost directly attributable to the acquisition and any consideration receivable or payable contingent on future events or on compliance with certain conditions. Any excess of the cost of the investment over the Group's share of the net fair value of the associate's identifiable net assets at the acquisition date is recognised as goodwill under associates in the consolidated statement of financial position. Any excess of the Group's share of the net fair value of the associate's identifiable net assets over the cost of the investment at the acquisition date (bargain purchase) is recognised as income in the period in which the investment is acquired.

Appendix I provides details of the Company's subsidiaries, joint arrangements and associates, as well as the consolidation or measurement method used in preparing the accompanying consolidated annual accounts and other relevant information.

The financial statements of the subsidiaries, joint arrangements and associates used in the consolidation process have the same reporting date and refer to the same period as those of the Parent.

The operations of the Company and its subsidiaries have been consolidated applying the following basic principles:



- The accounting principles and criteria used by the Group companies have been harmonised with those applied by the Parent.
- Translation of foreign operations:
 - Balances in the financial statements of foreign companies have been translated using the closing exchange rate for assets and liabilities, the average exchange rate for income and expenses and the historical exchange rate for capital and reserves.
 - All resulting exchange differences are recognised as translation differences in other comprehensive income.
 - These criteria are also applicable when translating the financial statements of equity-accounted investees, with translation differences attributable to the Group recognised in other comprehensive income.
- All balances and transactions between fully consolidated companies have been eliminated on consolidation.
- Margins on invoices between Group companies for capitalisable goods or services were eliminated at the transaction date.

e) Non-controlling interests

Non-controlling interests in subsidiaries are recognised at the acquisition date at the proportional part of the fair value of the identifiable net assets. Non-controlling interests are disclosed in consolidated equity separately from equity attributable to shareholders of the Company. Non-controlling interests' share in consolidated profit or loss for the year and in consolidated comprehensive income for the year is disclosed separately.

Transactions with non-controlling interests are recognised as transactions with equity holders of the Group. As such, the difference between the consideration paid in the acquisition of a non-controlling interest and the corresponding proportion of the carrying amount of the subsidiary's net assets is recognised in equity. Similarly, the gains or losses on disposal of non-controlling interests are also recognised in the Group's equity.

f) Comparative information

Group management has included comparative information for 2015 in the accompanying consolidated annual accounts. As required by IFRS-EU, these consolidated annual accounts for 2016 include comparative figures for the prior year.

In 2016 a share split was performed resulting in four new shares per each old share. For the purpose of comparing the Euros per share in both years, data on the Euros per share in 2015 are presented on a like-for-like basis in relation to the split performed in 2016.

g) Changes in the consolidated Group

The changes in the consolidated Group in 2016 are as follows:



- On 27 January 2016 Red Eléctrica Chile SpA acquired 50% of the shares of Transmisora Eléctrica del Norte, S.A. (hereinafter TEN), the principal activity of which is the performance of the Mejillones-Cardones project to construct a 600 km-long 500 kV electricity transmission line in northern Chile and the related substations. Since it is a joint venture it was accounted for at that date using the equity method (see note 8).
- Transmisora Eléctrica del Sur 3, S.A. (hereinafter TESUR 3), with registered office in Lima (Peru), was incorporated on 10 February 2016, with the principal activity of electricity transmission and the operation and maintenance of electricity transmission networks. This company was incorporated with Red Eléctrica Internacional, S.A.U. (hereinafter REI) as sole shareholder and is fully consolidated.

The changes in the consolidated Group in 2015 were as follows:

- Transmisora Eléctrica del Sur 2, S.A. (hereinafter TESUR 2), with registered office in Lima (Peru), was incorporated on 13 March 2015, with the principal activity of 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. (hereinafter REDESUR).
- On 29 June 2015, Red Eléctrica Corporación, S.A., as sole shareholder, incorporated Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. following the partial spin-off of REI. The company's statutory activity comprises grid operations and the provision of telecommunications services to third parties.
- An agreement was signed on 3 July for the sale of the shares in TESUR by REI (55% interest) and AC Captales (45%) to REDESUR, which is now the sole shareholder of TESUR.
- On 17 September 2015, the Company, as sole shareholder, incorporated Red Eléctrica de Infraestructuras en Canarias, S.A.U. (REINCAN), whose statutory activity comprises the construction of energy storage facilities in non-mainland and isolated systems.
- On 19 November 2015 REI, as sole shareholder, incorporated Red Eléctrica Chile SpA (hereinafter RECH), whose principal activity comprises the acquisition, holding, administration and management of the Group's investments in Chile.

3. INDUSTRY REGULATIONS

Spanish electricity sector

The electricity sector regulatory reform that had been carried out in past years was completed in 2013 with the publication of Electricity Industry Law 24/2013 of 26 December 2013, which repeals Law 54/1997, with the exception of certain additional provisions, and the regulatory developments of this law approved in the last three years.

Electricity Industry Law 24/2013 has a two-fold objective. On the one hand, it aims to compile into a single piece of legislation all of the statutory provisions introduced by the different regulations published to reflect the fundamental changes occurring in the electricity sector since Law 54/1997 came into force. On the other, it intends to provide measures to guarantee the long-term financial sustainability of the electricity sector, with a view to ensuring the structural balance between the system's revenues and costs.



Law 24/2013 also reviews the set of provisions that made up Law 54/1997, in particular those concerning the remit of the General State Administration, the regulation of access and connection to the networks, the penalty system, and the nomenclature used for the tariffs applied to vulnerable consumers and those still availing of the regulated tariff.

With respect to regulation of the activities conducted by the Company, the new Law 24/2013 maintains the Company's appointment as the sole transmission agent and system operator, as well as assigning it the role of transmission network manager. Furthermore, Law 24/2013 upholds the current corporate structure for these activities since it does not repeal the twenty-third additional provision of Law 54/1997, which made specific reference to the Group's Parent, Red Eléctrica Corporación, S.A., and assigned to the subsidiary Red Eléctrica de España, S.A.U. the functions of sole transmission agent, system operator and transmission network manager, the latter activity being conducted through a specific organisational unit that is sufficiently segregated from the transmission activity for accounting and functional purposes.

Other relevant aspects of the regulation pursuant to Law 24/2013 of the activities performed by the Company are as follows:

- This Law acknowledges the natural monopoly in the transmission activity, arising from the economic efficiency afforded by a sole grid. Transmission is liberalised by granting widespread third-party access to the network, which is made available to the different electricity system agents and consumers in exchange for payment of an access charge.

Remuneration for this activity has been set by the government on the basis of the general principles laid down in the law, as developed in Royal Decree 1047/2013 of 27 December 2013, which set out the new remuneration system for the transmission activity, and by Royal Decree 1073/2015 of 27 November 2015, which amends certain provisions in Royal Decree 1047/2013.

The remuneration model for the transmission activity is completed with Ministry of Industry, Energy and Tourism Order IET/2659/2015 of 11 December 2015, approving standard facilities and benchmark unit values for investment, operation and maintenance by asset that are to be used in calculating the remuneration allocable to companies that own electricity transmission facilities, and with the publication in 2016 of various resolutions required for effective implementation of the Order. Accordingly, 2016 was the first year in which the recognised cost of the transmission activity was calculated based on the new remuneration model defined by Royal Decree 1047/2013.

- As electricity system operator and transmission network manager, the Company's main function is to guarantee the continuity and security of the electricity supply, as well as to ensure the correct coordination of the production and transmission system, exercising its duties in cooperation with the operators and agents of the Spanish electricity market (*Mercado Ibérico de la Energía Eléctrica*) while observing the principles of transparency, objectivity and independence. The Company has also been entrusted with developing and expanding the high-voltage transmission network so as to guarantee the maintenance and improvement of a grid based on standardised and consistent criteria, managing the transit of



electricity between external systems that use the Spanish electricity system networks, and refusing access to the transmission network in the event of insufficient capacity.

In 2015 the certification process for Red Eléctrica as transmission network manager for the Spanish electricity system, as provided in article 31.1 of Law 24/2013, was completed following publication in the Official Journal of the European Union of 12 February 2015 of the Notification of the Spanish Government pursuant to article 10(2) of Directive 2009/72/EC of the European Parliament and of the Council ('Electricity Directive') concerning common rules for the internal market in electricity regarding the designation of Red Eléctrica de España, S.A.U. as transmission system operator in Spain.

The Company is also responsible for the functions of settlement, notification of payments and receipts, and management of guarantees relating to security of supply and the effective diversion of units generated and consumed, as well as for short-term energy exchanges aimed at maintaining the quality and security of supply.

Furthermore, the Company manages the technical and economic dispatch for electricity supply from non-mainland electricity systems (Balearics, Canaries, Ceuta and Melilla), and is responsible for the settlements of payments and receipts arising from the economic dispatch of electricity generated by these systems.

Regarding the Company's remit in the non-mainland electricity systems, in 2015 the Soria-Chira 200 MW hydroelectric pumping power plant project in Gran Canaria was transferred to the system operator, as stipulated in Order IET/728/2014 of 28 April 2014. Once Red Eléctrica had assumed ownership of the project in 2016, and pursuant to Law 17/2013, for the purposes of implementing a new energy model in Gran Canaria to improve security of supply, system security and the integration of renewable energies, a revised project was submitted in July 2016, which includes technical and environmental improvements. The revised project was declared to be of strategic interest by the Regional Government of the Canary Islands in 2016 and has been submitted for consideration by the government. As such, it is estimated that construction may begin soon.

International electricity sector

The Red Eléctrica Group has built electricity transmission facilities through REI. At international level, it now operates and maintains these facilities in Peru. Various electricity transmission facilities were also under construction both in Peru and in Chile at the end of 2016.

- **Electricity sector in Peru**

This country has liberalised its electricity industry and applies a regulation model based on regulated tariffs for the transmission activity.

Regulation of the electricity industry in Peru is mostly set out in the Electricity Concessions Law, Decree Law No. 25844 enacted in 1992, and the related regulations, Supreme Decree No. 009-93-EM enacted in 1993, and the various amendments and/or extensions thereto, including Law No. 28832, "Law for the Efficient Development of Electricity Generation", enacted in 2016.



Under the Electricity Concessions Law, the National Interconnected System (SEIN) is divided into three major segments: generation, transmission and distribution. Pursuant to this law and the Law for the Efficient Development of Electricity Generation, the operations of generation power plants and transmission systems are subject to the provisions of the System Economic Operation Committee of the National Interconnected System (COES-SINAC), which coordinates operations at minimum cost, so as to ensure the security of electricity supply and enhance the use of energy resources, as well as plan development of the National Interconnected System (SEIN) and administrate the short-term market.

The concession arrangements signed in Peru comply with Supreme Decree No. 059-96-PCM (Public Works Concessions Law), Legislative Decree No. 1012 (Framework Law on Public-Private Partnerships) and Law No. 28832. The overall legal framework enables the State to provide special guarantees to concession holders and sets out the special tariff conditions, as the tariff regime may differ from that set out in the Electricity Concessions Law. Under these conditions, the values for investment and operation and maintenance stipulated in the Group's concession arrangements are adjusted each year or when appropriate (according to the tariff regime) in line with the variation in the Finished Goods Less Food and Energy index (Series ID: WPSOP3500) published by the Bureau of Labor Statistics of the United States Government.

The “Procedures for Setting Regulated Prices” were approved through OSINERGMIN (Peruvian Supervisory Body for Energy and Mining Investment) Resolution No. 080-2012-OS/CD and amendments thereto. These rules contain information relating to the bodies involved in setting regulated prices, their competences and obligations, the price-setting deadlines, the administrative appeals that may be filed, the terms for filing and resolving such appeals, as well as the body responsible for their resolution.

The rules on “Tariffs and Remuneration for Secondary Transmission Systems (STS) and Complementary Transmission Systems (CTS)” were approved through OSINERGMIN Resolution No. 050-2011-OS/CD and amendments. These rules set forth the criteria and methodology for determining the tolls and remuneration for the STS and/or CTS services.

Lastly, the “Annual Revenue Settlement Procedures for the Electricity Transmission Service” for the (i) “Primary Transmission System (PTS) and Secondary Transmission System (STS) under the BOOT Arrangement Model”, (ii) “Guaranteed Transmission System (GTS)” and (iii) “Complementary Transmission System (CTS)” were approved through OSINERGMIN Resolutions Nos. 335-2004-OS/CD, 200-2010-OS/CD and 004-2015-OS/CD, respectively. These rules provide for annual updates to remuneration, mainly in respect of the differences arising between the amounts stipulated in the concession arrangements (in US Dollars) and the tariff regime in Peru established in local currency (in Sols).

- **Electricity sector in Chile**

The legal framework governing the electricity transmission business in Chile is contained in Decree with Force of Law No. 4/2006, which sets out the revised, coordinated and systematised text of Ministry of Mining Decree with Force of Law No. 1, of 1982, the General Electricity Services Law (DFL No. 1/1982) and subsequent amendments thereto.

The new Law 20,936 amends the General Electricity Services Law as concerns electricity transmission and creates a coordinating body that is independent from the Chilean national electricity system. As regards electricity transmission, the law redefines the transmission systems and classifies them into five segments: National Transmission System, Zonal Transmission Systems, Dedicated Systems, Systems for Development Hubs and International Interconnection



Systems. This law covers the planning of transmission over a long-term horizon and regulates the tariffs of the national system, zonal system and system for development hubs, as well as payment for use of the dedicated transmission facilities by users subject to the price regulation. Prices are determined by the Chilean National Energy Commission (CNE) every four years through processes that involve the participation of companies in the sector, users, the institutions concerned and, were discrepancies to exist, the panel of experts.

The pricing policy takes into account the efficient acquisition and installation costs at market prices, which are annualised based on a useful life calculated every three tariff periods (12 years) and a variable discount rate calculated by the CNE every four years. Owners of regulated transmission facilities should receive the Annual Transmission Value by Segment, based on the sum of actual tariff revenues and a single charge for use associated with each segment and directly applied to end users.

Law 20,936 provides that the new payment scheme for use of national facilities shall take effect as from 1 January 2019, at which time a transitional period extending to 31 December 2034 will commence. During this period, payments by electricity producers for usage associated with supply agreements entered into vis-à-vis unregulated and regulated customers before this new law came into force will be subject to the same general rules for calculating backbone transmission payments (presently national), with certain adaptations. The resulting input tolls will decrease each year and the amount thereof will be paid through customer demand.

On 3 February 2016 the Chilean Ministry of Energy published a decree identifying the backbone transmission facilities (presently national) and the new Investment Values, the Annual Investment Value and the Cost of Operation, Maintenance and Administration, plus the Annual Transmission Value by Segment of the backbone facilities, for the period from 1 January 2016 up to 31 December 2019, as well as the indexation formulas applicable in this period. The determination of the national facilities and the related Annual Transmission Value by Segment is reviewed every four years by a study put out to international tender.

In 2014 and 2015 the third tariff-setting process for backbone facilities (national) was conducted to determine the tariffs and indexation formulas for the four-year period from 2016 to 2019, which were set by Ministry of Energy Decree 23T on 3 February 2016 and were applicable retrospectively as from 1 January 2016.

Under transitional article 11 of Law 20,936, during the period from 1 January 2016 to 31 December 2017, Decree No. 14 and the subtransmission tariffs set therein will remain in force, with the exception of the payment corresponding to electricity producers.

In 2014 the new studies of the zonal transmission systems were conducted, which served as the basis to determine the tariffs and indexation formulas for the four-year period from 2016 to 2019. Under article 12 of Law 20,936, during the period in which Decree No. 14 remains in force, the process to set the new zonal transmission tariffs, which will be effective from 1 January 2018 to 31 December 2019, will be ongoing and ultimately concluded.

Telecommunications

The Spanish telecommunications sector is governed by General Telecommunications Law 9/2014 of 9 May 2014 (GTL), which mainly seeks to foster competition in the market and guarantee access to the networks.



The European framework comprises Directive 2009/136/EC of the European Parliament and of the Council of 25 November 2009 (regarding users' rights) and Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 (regulatory improvements). Based on this legislation, the General Telecommunications Law introduces measures aimed at creating an appropriate framework for investing in the deployment of new generation networks, thereby enabling operators to offer innovative services that are more technologically adapted to people's needs.

In line with the foregoing, special note should also be taken of Directive 2014/61/EU of the European Parliament and the Council of 15 May 2014 on measures to reduce the cost of deploying high-speed electronic communications networks, which mainly seeks to expedite implementation of the "Digital Agenda" of the European Union (EU) (published in May 2010). This directive was transposed by Royal Decree 330/2016 of 9 September 2016, on measures to reduce the cost of deploying high-speed electronic communications networks.

As regards competition, in accordance with the European Commission Recommendation of 9 October 2014 (on relevant product and service markets within the electronic communications sector susceptible to regulation in accordance with Directive 2002/21/EC), the Spanish National Markets and Competition Commission (CNMC) periodically defines the various telecommunications markets and assesses the existence of operators with sufficient market power. These tasks, which are considered in the GTL, may lead to the implementation of specific regulations for that market.

To this end, and in order to authorise the acquisition by REINTEL of the rights to use and manage the operation of the fibre optic cables of Administrador de Infraestructuras Ferroviarias (Adif), the CNMC analysed the dark fibre backbone network lease activity, concluding that the environment is sufficiently competitive and this activity may therefore be conducted on a free competition basis.

The regulation also stipulates that access to infrastructure that may be used to host public communications networks must be guaranteed. Under Spanish and European law, REINTEL is obliged to meet all access requests under fair and reasonable terms and conditions. This obligation is fulfilled in view of the nature of the dark fibre business.

4. SIGNIFICANT ACCOUNTING PRINCIPLES

The accounting principles used in preparing the accompanying consolidated annual accounts have been applied consistently to the reported periods presented and are as follows:

a) Business combinations

The Group has applied IFRS 3 Business Combinations, revised in 2008, to transactions carried out on or after 1 January 2010.

The Group applies the acquisition method for business combinations.

The acquisition date is the date on which the Group obtains control of the acquiree. The consideration transferred in a business combination is calculated as the sum of the acquisition-date fair values of the assets transferred, the liabilities incurred or assumed, the equity



instruments issued and any consideration contingent on future events or compliance with certain conditions in exchange for control of the acquiree. The consideration transferred excludes any payment that does not form part of the exchange for the acquiree. Acquisition costs are recognised as an expense when incurred.

For business combinations achieved in stages, the excess of the consideration given, plus the value assigned to non-controlling interests and the fair value of the previously held interest in the acquiree, over the net value of the assets acquired and liabilities assumed, is recognised as goodwill. Any shortfall, after assessing the consideration given, the value assigned to non-controlling interests and to the previously held interest, and after identifying and measuring the net assets acquired, is recognised in profit or loss. The Group recognises the difference between the fair value of the previously held interest in the acquiree and the carrying amount in consolidated profit or loss, in accordance with its classification. The Group also reclassifies amounts deferred in other comprehensive income relating to the previously held interest to consolidated profit or loss or reserves, based on the nature of each item.

b) Property, plant and equipment

Property, plant and equipment primarily comprise technical electricity facilities and are measured at cost of production or acquisition, as appropriate, less accumulated depreciation and impairment. This cost includes the following items, where applicable:

- Borrowing costs directly attributable to property, plant and equipment under construction accrued on external financing solely during the construction period. Nevertheless, capitalisation of borrowing costs is suspended when active development is interrupted for extended periods, unless the delay is necessary in order to bring the asset to a working condition.
- Operating costs directly related with property, plant and equipment under construction for projects executed under the supervision and management of Group companies.

The Group companies transfer work in progress to property, plant and equipment in use once these items come into service and provided that the assets are in working condition.

Subsequent to initial recognition of the asset, only those costs incurred which will generate probable future profits and for which the amount may reliably be measured are capitalised. Repair and maintenance costs are recognised in consolidated profit or loss as incurred.

Property, plant and equipment are depreciated by allocating the depreciable amount of the asset on a straight-line basis over its useful life, which is the period during which the companies expect to use the asset.

Property, plant and equipment are depreciated applying the following rates:



	Annual depreciation rate
Buildings	2%-10%
Technical telecommunications facilities	5%
Technical electricity facilities	2.5%-8.33%
Other installations, machinery, equipment, furniture and other items	4%-25%

The Group 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.

Property, plant and equipment primarily comprise technical electricity facilities. Most undepreciated property, plant and equipment is depreciated at a rate of 2.5%.

The Group reviews the residual values and useful lives of assets and adjusts them, if necessary, at the end of each reporting period. The Group will perform complementary analyses of these indicators in view of the entry into force of the new remuneration regime applicable to electricity transmission assets in Spain, once all the parameters of the new regime have been definitively established (see note 3).

The Group measures and determines impairment to be recognised or reversed in respect of the value of its cash generating units (CGUs) based on the criteria in section h) of this note.

c) Intangible assets

Intangible assets are recognised at acquisition cost, which is periodically reviewed and adjusted in the event of a decline in value. Intangible assets include the following:

- Administrative concessions

The Group operates various assets, located mainly in Peru, under service concession contracts awarded by different public entities. Based on the characteristics of the contracts, the Group analyses whether they fall within the scope of IFRIC 12 Service Concession Arrangements.

For concession arrangements subject to IFRIC 12, construction and other services rendered are recognised using the criteria applicable to income and expenses.

The consideration received by the Group is recognised at the fair value of the service rendered, as a financial asset or intangible asset, based on the contract clauses. The Group recognises the consideration received for construction contracts as an intangible asset to the extent that it is entitled to pass on to users the cost of access to or use of the public service, or it has no unconditional contractual right to receive cash or another financial asset.



The contractual obligations assumed by the Group to maintain the infrastructure during the operating period, or to carry out renovation work prior to returning the infrastructure to the transferor upon expiry of the concession arrangement, are recognised using the accounting policy described for provisions, to the extent that such activity does not generate revenue.

Concession arrangements not subject to IFRIC 12 are recognised using general criteria.

Administrative concessions have a finite useful life and the associated cost is recognised as an intangible asset. Details of the useful and residual lives of these concessions are provided in note 5.

- Computer software

Computer software licences are capitalised at cost of acquisition or cost of preparation for use.

Computer software maintenance costs are charged as expenses when incurred. Computer software is amortised on a straight-line basis over a period of three to five years from the date on which each program comes into use.

- Development expenses

Development expenses directly attributable to the design and execution of tests for new or improved computer programs that are identifiable, unique and likely to be controlled by the Group are recognised as intangible assets when it is probable that the project will be successful, based on its economic and commercial feasibility, and the associated costs can be estimated reliably. Costs that do not meet these criteria are charged as expenses when incurred. Development expenses are capitalised and amortised, from the date the associated asset comes into service, on a straight-line basis over a period of no more than five years. Computer software maintenance costs are charged as expenses when incurred.

- Intangible assets under development

Administrative concessions at the construction stage are recognised as intangible assets under development and measured in line with the amount to be disbursed until completion of the works, in accordance with IFRIC 12.

d) Investment property

The Group companies measure their investment property at cost of acquisition. The market value of the Group's investment property is disclosed in note 7 to the consolidated annual accounts.

Investment property, except land, is depreciated on a straight-line basis over the estimated useful life, which is the period during which the companies expect to use the assets. Investment property is depreciated over a period of 50 years.

e) Leases

The Group 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 Group are classified as finance leases. Assets recognised as finance leases are presented in the consolidated statement of financial position based on the nature of the leased asset.

f) Financial assets and financial liabilities

Financial instruments are classified on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the economic substance of the contractual arrangement and the definitions of a financial asset, a financial liability and an equity instrument in IAS 32 "Financial Instruments: Presentation".

The Group recognises financial instruments when it becomes party to the contract or legal transaction, in accordance with the terms set out therein.

Financial instruments are classified into the following categories: financial assets and financial liabilities at fair value through profit or loss, separating those initially designated from those held for trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets and financial liabilities at amortised cost. Financial instruments are classified into different categories based on the nature of the instruments and the Group's intentions on initial recognition.

- Financial assets: The Group classifies financial assets, excluding equity-accounted investments, into the following categories:

- Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other financial asset categories.

Loans and receivables are initially recognised at fair value, including transaction costs, and are subsequently measured at amortised cost using the effective interest method.

Loans and receivables arising from ordinary activities, for which the inflow of cash or cash equivalents is deferred, are measured at the fair value of the consideration, determined by discounting all future receipts using an imputed rate of interest.

The Company tests the assets for impairment at each reporting date. The impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the loss is recognised in consolidated profit or loss.

- Available-for-sale financial assets: The Group classifies in this category non-derivative financial instruments that are designated as such or which do not qualify for recognition in the aforementioned categories. These are basically 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 initially recognised at fair value plus transaction costs directly attributable to the acquisition. They are subsequently 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 quotation of listed securities below their cost is also objective evidence of impairment.

Dividends from equity investments classified as available-for-sale are recognised in the consolidated income statement when the Company's right to receive payment is established.

- Cash and cash equivalents: Cash and cash equivalents include cash on hand and demand deposits in financial institutions. They also include other short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. An investment normally qualifies as a cash equivalent when it has a maturity of less than three months from the date of acquisition.
- Financial liabilities: Financial liabilities, which include loans, payment obligations and similar commitments, are initially recognised at fair value less any transaction costs incurred. Such debt is subsequently measured at amortised cost, using the effective interest method, except in the case of transactions for which hedges have been arranged (see section n).

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 as non-current.

The Group derecognises all or part of a financial liability when it either discharges the liability by paying the creditor, or is legally released from primary responsibility for the liability either by process of law or by the creditor.

The exchange of debt instruments between the Group and the counterparty or substantial modifications of initially recognised liabilities are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, providing the instruments have substantially different terms.

The Group considers the terms to be substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

If the exchange is accounted for as an extinguishment of the financial liability, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

The difference between the carrying amount of a financial liability, or part of a financial liability, extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or loss.



The fair value measurements of financial assets and financial liabilities are classified on the basis of a hierarchy that reflects the relevance of the inputs used in measuring the fair value. The hierarchy comprises three levels:

- Level 1: measurement is based on quoted prices for identical instruments in active markets.
- Level 2: measurement is based on inputs that are observable for the asset or liability.
- Level 3: measurement is based on inputs derived from unobservable market data.

g) Inventories

Inventories of materials and spare parts are measured at cost of acquisition, which is calculated as the lower of weighted average price and net realisable value. The Group companies assess the net realisable value of inventories at the end of each reporting period, recognising impairment in the consolidated income statement when cost exceeds market value or when it is uncertain whether the inventories will be used. When the circumstances that previously caused inventories to be written down no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the previously recognised impairment is reversed and recognised as income.

h) Impairment

The Group companies analyse the recoverability of their 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 in the consolidated income statement. An impairment loss is the difference between the carrying amount of an asset and its recoverable amount. The recoverable amount of the assets is the higher of their fair value less costs of disposal and their value in use. Value in use is calculated on the basis of expected future 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 consolidated income statement. Impairment losses on goodwill are not reversed in subsequent years.

i) Share capital, own shares and dividends

The share capital of the Company is represented by ordinary shares. The cost of issuing new shares, net of taxes, is deducted from equity.

Own shares are measured at cost of acquisition and recognised as a reduction in equity in the consolidated statement of financial position. Any gains or losses on the purchase, sale, issue or redemption of own shares are recognised directly in equity.

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.



j) Grants

Non-refundable government capital grants awarded by different official bodies to finance the Group's fixed assets are recognised once the corresponding investments have been made.

The Group recognises these grants under non-financial and other capital grants each year during the period in which depreciation is charged on the assets for which the grants were received.

Government assistance provided in the form of income tax deductions and considered as government capital grants is recognised applying the general criteria described in the preceding sections.

k) Non-current revenue received in advance

Non-current revenue received in advance, generally arising from long-term contracts or commitments, is recognised under revenue or other gains, as appropriate, over the term of the contract or commitment.

l) Provisions

- Employee benefits

- Pension obligations

The Group has defined contribution plans, whereby the benefit receivable by an employee upon retirement – usually 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 Group 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. The contributions are recognised under employee benefits when accrued.

- Other long-term employee benefits

Other long-term employee benefits include defined benefit plans for benefits other than pensions (such as medical insurance) for certain serving and retired personnel of the Group. The expected costs of these benefits are recognised under provisions 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 and the Structural Management Plan, which are measured each year. In 2015 the Company's Appointments and Remuneration Committee approved the implementation of a Structural Management Plan (hereinafter the "Plan") for certain members of the management team, with the aim of processing, in an orderly and efficient manner, the replacement and administration of the management positions covered in the Plan. Upon reaching the age of 62 whilst employed at the Group, the executives included in the Plan will be entitled to receive an amount equal to a maximum of 3.5



times their annual salary, depending on their category and annual fixed and variable remuneration at the date of leaving the Group. Participation in the Plan is subject to meeting certain conditions, and the Plan may be modified or withdrawn by the Group under certain circumstances, including a prolonged decline in the Group's results (see note 13).

- Other provisions

The Group 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 risk-free discount rate that reflects assessments of the time value of money. The increase in the provision due to the passage of time is recognised as an interest expense in the income statement.

m) 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 consolidated 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 consolidated profit or loss.

Transactions conducted in foreign currencies for which the Group 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.

n) Derivative financial instruments and hedging transactions

Derivative financial instruments are initially recognised in the consolidated statement of financial position 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 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.

IFRS 13 Fair Value Measurement defines fair value 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.

At the inception of the hedge the Group formally designates and documents the hedging relationships and the objective and strategy for undertaking the hedges. Hedge accounting is only applicable when the hedge is expected to be highly effective at the inception of the hedge and in subsequent years in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, throughout the period for which the hedge was designated (prospective analysis), and the actual effectiveness is within a range of 80%-125% (retrospective analysis) and can be reliably measured.

When a hedging instrument expires or is sold, or when it no longer qualifies for hedge accounting, any cumulative gain or loss recorded in equity at that time remains in equity, and is immediately reclassified to the consolidated income statement as and when changes in cash flows of the hedged item occur. Any cumulative gain or loss is also reclassified from equity to the consolidated income statement if the forecast transaction is no longer expected to occur.

The market value of the different derivative financial instruments is calculated as follows:

- The fair market value of derivative financial instruments quoted on an organised market is their quoted value at the reporting date.
- The Company calculates the fair value of derivative financial instruments that are not traded on organised markets using valuation techniques, including recent arm's length transactions between knowledgeable, willing parties, reference to other instruments that are substantially the same, discounted cash flow analyses using the market interest rates and exchange rates in force at the reporting date, and option pricing models enhanced to reflect the particular circumstances of the issuer.

The Group recognises the portion of the gain or loss on the fair value measurement of a hedging instrument that is determined to be an effective hedge in other comprehensive income. The ineffective portion and the specific component of the gain or loss or cash flows on the hedging instrument, excluding the measurement of the hedge effectiveness, are recognised with a debit or credit to finance costs or finance income.

The separate component of other comprehensive income associated with the hedged item is adjusted to the lesser of the cumulative gain or loss on the hedging instrument from inception of the hedge and the cumulative change in fair value or present value of the expected future cash flows on the hedged item from inception of the hedge. However, if the Group expects that all or a portion of a loss recognised in other comprehensive income will not be recovered in one or more future periods, it reclassifies into finance income or finance costs the amount that is not expected to be recovered.

Details of the fair value of the hedging derivatives used are disclosed in note 17. Details of changes in equity are provided in note 11.

o) Trade payables

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

**p) Income and expenses**

Revenue is measured at the fair value of the consideration received or receivable. Income and expenses are recognised on an accruals basis, irrespective of payments and receipts. The majority of the Group's revenues are regulated revenues from transmission and operation activities in Spain. Details of the implementing legislation governing the calculation of these revenues are provided in note 3 to the accompanying consolidated annual accounts.

Revenue associated with the rendering of telecommunications and reinsurance services is recognised by reference to the stage of completion of the transaction at the reporting date, provided the outcome of the transaction can be estimated reliably.

Revenue and expenses from construction contracts are recognised using the percentage of completion method, whereby revenue is recognised based on the percentage of the contract work completed at the end of the accounting period.

Interest income is recognised using the effective interest method.

Dividends are recognised when the right to receive payment is established.

q) 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.

Deferred tax assets and liabilities are recognised in respect of the temporary differences that arise from investments in subsidiaries and associates, except where the Group is able to control the timing of the reversal of the temporary differences and it is probable that they will reverse in the foreseeable future.

Red Eléctrica Corporación, S.A., Red Eléctrica de España, S.A.U., Red Eléctrica Financiaciones, S.A.U., Red Eléctrica Internacional, S.A.U., Red Eléctrica de Infraestructuras de Telecomunicación, S.A.U. and Red Eléctrica de Infraestructuras en Canarias, S.A.U. compose the Red Eléctrica tax group and file consolidated tax returns in Spain.



In addition to the factors to be considered for individual taxation, set out previously, the following factors are taken into account when determining the accrued income tax expense for the companies forming the consolidated tax group:

- Temporary and permanent differences arising from the elimination of profits and losses on transactions between Group companies, derived from the process of determining consolidated taxable income.
- Deductions and credits corresponding to each company forming the consolidated tax group. For these purposes, deductions and credits are allocated to the company that carried out the activity or generated the profit necessary to obtain the right to the deduction or tax credit.
- Temporary differences arising from the elimination of profits and losses on transactions between tax group companies are recognised by the company that generates the profit or loss, using the applicable tax rate.
- The Parent of the Group records the total consolidated income tax payable (recoverable) with a debit (credit) to receivables (payables) from/to Group companies and associates.
- The amount of the debt (credit) relating to the subsidiaries is recognised with a credit (debit) to payables (receivables) to/from Group companies and associates.

r) Earnings per share

Basic earnings per share are calculated by dividing the net profit for the year attributable to the Parent by the weighted average number of ordinary shares outstanding during the year, excluding own shares.

According to the consolidated annual accounts of the Red Eléctrica Group at 31 December 2016 and 2015, basic earnings per share are the same as diluted earnings per share, as no transactions that could have resulted in a change in those figures were conducted during those years.

s) Insurance

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

t) Environment

Costs derived from business activities intended to protect and improve the environment are charged as expenses in the year in which they are incurred. Property, plant and equipment acquired to minimise environmental impact and to protect and improve the environment are recognised as an increase in property, plant and equipment.



u) Non-current assets held for sale

Non-current assets are classified as held for sale when the carrying amount will be recovered principally through a sale transaction, provided that the sale is considered highly probable. These assets are measured at the lower of carrying amount and fair value less costs to sell.

v) Share-based payments

The Group 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 consolidated income statement. All shares delivered as payment are taken from the own shares held by the Parent.

w) Contingent assets and liabilities

Contingent assets are not recognised in financial statements since this could result in the recognition of income that may never be realised. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Contingent liabilities are not recognised in financial statements. Contingent liabilities are assessed continually and if it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

5. INTANGIBLE ASSETS

Movement in intangible assets and details of accumulated amortisation during 2016 and 2015 are as follows:



RED ELÉCTRICA GROUP
Movement in intangible assets
2016 and 2015
(Expressed in thousands of Euros)

	31 December 2014	Additions	Exchange rate fluctuations	31 December 2015	Additions	Exchange rate fluctuations	31 December 2016
Cost							
Administrative concessions	112,903	418	13,006	126,327	93	4,151	130,571
Development expenses and computer software	17,655	12	1	17,668	-	3	17,671
Intangible assets under development	-	3,133	-	3,133	18,179	103	21,415
Total cost	130,558	3,563	13,007	147,128	18,272	4,257	169,657
Accumulated amortisation							
Administrative concessions	(4,984)	(5,679)	(651)	(11,314)	(5,619)	(627)	(17,560)
Development expenses and computer software	(16,505)	(835)	(3)	(17,343)	(182)	-	(17,525)
Total accumulated amortisation	(21,489)	(6,514)	(654)	(28,657)	(5,801)	(627)	(35,085)
Impairment	-	-	-	-	-	-	-
Carrying amount	109,069	(2,951)	12,353	118,471	12,471	3,630	134,572

Operating expenses of Euros 5,774 thousand incurred directly in connection with intangible assets were capitalised in 2016 (Euros 2,915 thousand in 2015).

In 2016 and 2015 no borrowing costs were capitalised as an increase in intangible assets.

At 31 December 2016 the Company has fully amortised intangible assets amounting to Euros 17,289 thousand, most of which comprise development expenses and computer software.

Administrative concessions reflect the technical energy facilities constructed and operated by the Group under concession in Peru.

Intangible assets under development in 2016 are related with the construction work carried out by both TESUR 2 and TESUR 3 for the concession facilities formed by the Azángaro-Juliaca-Puno transmission line and related substations, and the Montalvo-Los Héroes transmission line and related substations, respectively. In 2015 all of the work was carried out by TESUR 2.

At 31 December 2016 the carrying amount of intangible assets located outside of Spain is Euros 134,432 thousand.

Details of service concession contracts awarded by different public entities and under operation and/or construction at 31 December 2016 are as follows:



(In thousands of Euros)	REDESUR	TESUR	TESUR 2	TESUR 3
Grantor	Peruvian State	Peruvian State	Peruvian State	Peruvian State
Activity	Electricity transmission	Electricity transmission	Electricity transmission	Electricity transmission
Country	Peru	Peru	Peru	Peru
Concession period from start-up of commercial operations	30 years	30 years	30 years	30 years
Remaining useful life	15 years	28 years	15 months construction + 30 years operation	30 months construction + 30 years operation
Tariff review frequency	Annual	Annual	Annual	Annual
Carrying amount at 31/12/2016	46,829	66,182	19,669	1,746
Carrying amount at 31/12/2015	48,694	66,319	3,133	-
Revenue in 2016	15,581	6,941	11,025	-
Profit/(loss) for 2016	3,250	645	(196)	(27)
Renewal options	Not stipulated in contract	Not stipulated in contract	Not stipulated in contract	Not stipulated in contract

6. PROPERTY, PLANT AND EQUIPMENT

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



RED ELÉCTRICA GROUP
Movement in property, plant and equipment
2016 and 2015
(Expressed in thousands of Euros)

	31 December 2014	Additions	Exchange rate fluctuations	Exits, disposals, reductions and write-downs	Transfers	31 December 2015	Additions	Exchange rate fluctuations	Exits, disposals, reductions and write-downs	Transfers	31 December 2016
Cost											
Land and buildings	74,207	91	36	-	1,786	76,120	-	13	-	3,463	79,596
Technical telecommunications facilities	431,088	326	-	-	2,587	434,001	-	-	-	1,734	435,735
Technical electricity facilities	12,423,333	-	-	(4)	374,529	12,797,858	9,301	-	(34,560)	597,662	13,370,261
Other installations, machinery, equipment, furniture and other items	167,605	156	65	(54)	23,166	190,938	300	88	(171)	23,700	214,855
Technical electricity facilities under construction	702,049	397,101	-	-	(359,260)	739,890	367,116	-	-	(593,118)	513,888
Advances and under construction	21,836	46,581	6	-	(42,808)	25,615	48,295	3	-	(33,441)	40,472
Total cost	13,820,118	444,255	107	(58)	-	14,264,422	425,012	104	(34,731)	-	14,654,807
Accumulated depreciation											
Buildings	(18,970)	(1,293)	(2)	-	-	(20,265)	(1,344)	(2)	-	-	(21,611)
Technical telecommunications facilities	(2,392)	(21,561)	-	-	-	(23,953)	(21,730)	-	-	-	(45,683)
Technical electricity facilities	(4,659,832)	(449,272)	-	-	-	(5,109,104)	(459,530)	-	-	4,865.0	(5,563,769)
Other installations, machinery, equipment, furniture and other items	(132,037)	(10,849)	(17)	26	-	(142,877)	(15,751)	(41)	126	(4,865.0)	(163,408)
Total accumulated depreciation	(4,813,231)	(482,975)	(19)	26	-	(5,296,199)	(498,355)	(43)	126	-	(5,794,471)
Impairment	(83,625)	-	-	-	-	(83,625)	-	-	-	-	(83,625)
Carrying amount	8,923,262	(38,720)	88	(32)	-	8,884,598	(73,343)	61	(34,605)	-	8,776,711



Technical electricity facilities are assets that are subject to regulated remuneration (see note 3). The main additions to technical electricity facilities in 2016 and 2015 are investments in electricity transmission facilities in Spain.

Technical telecommunications facilities essentially consist of the concession of the rights to use and manage the operation of the fibre optic cable network and other related items, pursuant to the 20-year agreement entered into with Adif in 2014. The agreement has been classified as a finance lease, given that substantially all the risks and rewards incidental to ownership of the assets were transferred.

Property, plant and equipment are measured at cost of acquisition, less any accumulated depreciation and impairment. Cost of acquisition includes the price paid for the asset, personnel expenses, operating expenses and any borrowing costs directly attributable to the construction or manufacture of the asset.

During 2016, the companies capitalised construction-related borrowing costs of Euros 7,547 thousand as an increase in property, plant and equipment (Euros 13,475 thousand in 2015). The weighted average rate used to capitalise borrowing costs was 2.0% in 2016 (2.57% in 2015).

Operating expenses of Euros 34,624 thousand incurred directly in connection with property, plant and equipment under construction were capitalised in 2016 (Euros 17,804 thousand in 2015). In 2016 the Group's capitalised expenses directly related to the construction of facilities include all operating expenses incurred to provide support to the units directly involved in the activity.

At 31 December 2016, the amount of Euros 34,731 thousand shown under exits, disposals, reductions and write-downs mainly reflects adjustments in the acquisition cost of transmission assets acquired from electricity distributors in previous years, based on the conditions of the signed agreements.

At 31 December 2016 and 2015 impairment losses essentially comprise adjustments to the carrying amount of facilities for which there are doubts as to whether they will generate sufficient future income. There were no indications of impairment in 2015 and 2016. Consequently, following an analysis of the uncertainties surrounding the generation of future revenues, no movement was recorded in impairment of property, plant and equipment.

At 31 December 2016 the carrying amount of property, plant and equipment located outside of Spain is Euros 1,309 thousand.

At 31 December 2016 the Company has fully depreciated property, plant and equipment amounting to Euros 1,458,864 thousand, of which Euros 1,335,823 thousand comprises technical electricity facilities (Euros 1,399,721 thousand in 2015, of which Euros 1,282,531 thousand comprised technical electricity facilities).

Details of capital grants and other non-current revenue received in advance in relation to property, plant and equipment are provided in note 12.

The Group has taken out insurance policies to cover the risk of damage to its property, plant and equipment. These policies provide adequate protection against the risks covered.

The Group has no firm commitments to purchase significant amounts of property, plant and equipment relative to its present volume of assets, and to the investments it makes and plans to make. The Group periodically places orders to cover needs related to its investment plan. The various amounts in the aforementioned orders will normally materialise in the form of delivery



orders as and when the different projects included in the plan are capitalised. Therefore, they do not constitute firm purchase commitments at the time of issue.

7. INVESTMENT PROPERTY

Movement in the Group's investment property in 2016 and 2015 is as follows:

RED ELÉCTRICA GROUP					
Movement in investment property					
2016 and 2015					
(Expressed in thousands of Euros)					
	31		31		31
	December		December		December
	<u>2014</u>	<u>Additions</u>	<u>2015</u>	<u>Additions</u>	<u>2016</u>
Cost					
Investment property	2,910	-	2,910	-	2,910
	-----	-----	-----	-----	-----
Total cost	2,910	-	2,910	-	2,910
Accumulated depreciation					
Investment property	(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.

8. EQUITY-ACCOUNTED INVESTEEES

In January 2016 Transmisora Eléctrica del Norte, S.A. (TEN), in which the Group holds a 50% interest through Red Eléctrica Chile SpA, was incorporated into the consolidated Red Eléctrica Group. As a joint venture, this company is incorporated into the financial statements of the Red Eléctrica Group using the equity method (see note 2 d).

TEN was incorporated on 1 March 2007 and is in charge of undertaking the project for the construction of a 500-kV dual-circuit alternating current transmission line spanning approximately 580 km which will enable electricity to be transmitted between Mejillones, in the Far North Interconnected System, and Copiapó, in the northern part of the Central Interconnected System in Chile.



The acquisition cost was US Dollars 217,560 thousand (Euros 199,816 thousand) and the main financial indicators at the acquisition date are as follows:

	Key financial indicators (in thousands of US Dollars) at 27 January 2016			
	<u>Total assets</u>	<u>Equity</u>	<u>Total liabilities</u>	<u>Profit for the year</u>
Transmisora Eléctrica del Norte S.A. (TEN)	244,622	53,426	191,196	129

Movement during the year is as follows:

<u>Company</u>	<u>Country</u>	<u>Activity</u>	<u>%</u>	(Thousands of Euros)						
				<u>31 December 2015</u>	<u>Acquisition price</u>	<u>Share of loss</u>	<u>Increase in the investment</u>	<u>Translation Differences</u>	<u>Valuation adjustments</u>	<u>31 December 2016</u>
Transmisora Eléctrica del Norte S.A. (TEN)	Chile	Electricity transmission and operation and maintenance of electricity transmission networks.	50%	-	199,816	(1,154)	800	6,558	(5,263)	200,757
				-----	-----	-----	-----	-----	-----	-----
				-	199,816	(1,154)	800	6,558	(5,263)	200,757
				=====	=====	=====	=====	=====	=====	=====

The key indicators at 31 December 2016 are:

Transmisora Eléctrica del Norte S.A. (TEN) (thousands of US Dollars)	31/12/2016
Non-current assets	647,651
Current assets	34,100
ASSETS	681,751
Non-current liabilities	513,701
Current liabilities	126,509
LIABILITIES	640,210
NET ASSETS	41,541
Gross operating loss	(469)
Profit/(loss) after tax	(2,413)



9. INVENTORIES

Details of inventories at 31 December 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Inventories	65,545	63,122
Impairment	(26,078)	(21,367)
	-----	-----
	39,467	41,755
	=====	=====

Inventories mainly reflect spare parts related to the technical electricity facilities.

The Group companies regularly test inventories for impairment based on the following assumptions:

- Impairment of old inventories, using inventory turnover ratios.
- Impairment for excess inventories, on the basis of estimated use in future years.

As a result, the Group recorded impairment losses of Euros 4,711 thousand in the consolidated income statement for 2016 (Euros 765 thousand in 2015).

10. TRADE AND OTHER RECEIVABLES

Details of trade and other receivables at 31 December 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Trade receivables	15,052	14,023
Other receivables	943,376	993,784
Current tax assets (note 20)	3,694	2,458
	-----	-----
	962,122	1,010,265
	=====	=====

Other receivables at 31 December 2016 and 2015 reflect the trend in settlements made by the regulator in 2016 and 2015 for regulated activities in Spain as a result of changes in collections and payments. At 31 December 2016 and 2015 the heading mostly comprises amounts pending invoicing and/or collection for regulated transmission and system operation activities. Under the settlement system set up by the Spanish regulator, some of these receivables are settled in the following year. This item also includes the revenue receivable derived from applying the



methodology set forth in the remuneration model in force for transmission activities in Spain, which stipulates that facilities entering into service in year 'n' are to be remunerated from year 'n+2' onwards.

There are no significant differences between the fair value and the carrying amount at 31 December 2016 and 2015. At 31 December 2016 and 2015 there are no significant amounts over 12 months past-due (see note 15).

11. EQUITY

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 Group can adjust the amount of dividends payable to shareholders, reimburse capital or issue shares.

The Group controls its capital structure on a gearing ratio basis, in line with sector practice. This ratio is calculated as net financial debt divided by the sum of the Group's equity and net financial debt. Net financial debt is calculated as follows:

	<u>Thousands of Euros</u>	
	<u>2016</u>	<u>2015</u>
Non-current payables	4,960,556	4,770,841
Current payables	294,051	562,658
Foreign currency derivatives	(53,730)	(40,765)
Cash and cash equivalents	(251,421)	(386,861)
	-----	-----
Net financial debt	4,949,456	4,905,873
	-----	-----
Equity	2,920,549	2,760,613
	-----	-----
Gearing ratio	62.9%	64.0%
	=====	=====

At 31 December 2016, the financial covenants stipulated in the contracts have been met.

On 3 August 2016 the rating agency Standard & Poor's issued a new report on Red Eléctrica maintaining its rating and outlook. Following this announcement, the Company and its subsidiary, Red Eléctrica de España, S.A.U., maintain long-term ratings of 'A-' and short-term ratings of 'A-2' with a stable outlook.

On 27 May 2016 the rating agency Fitch Ratings upgraded the Company's long-term rating to 'A' from 'A-' with a stable outlook. Following this announcement, the Company and Red Eléctrica de



España, S.A.U. maintain long-term ratings of 'A' and short-term ratings of 'F1', with a stable outlook.

Equity attributable to the Parent

- **Capital and reserves**

- **Share 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 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 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 the Parent's share capital (Euros 54,199 thousand).



- **Other reserves**

This heading includes voluntary reserves of the Parent, reserves in consolidated companies and first-time application reserves. At 31 December 2016 they amount to Euros 1,875,051 thousand (Euros 1,703,495 thousand in 2015).

In addition, this item includes statutory reserves amounting to Euros 293,656 thousand (Euros 293,656 thousand in 2015), particularly the following:

- 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, it may be transferred to freely distributable reserves, in accordance with Royal Decree-Law 2607/1996).
- As provided for by article 25 of Law 27/2014 of 27 November 2014, the tax group headed by the Company created a capitalisation reserve of Euros 29,110 thousand in 2015, 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 company forming the tax group has adjusted income tax for 2015 in connection with this reserve (see note 20).

- **Own shares**

At 31 December 2016 the Parent held 1,966,332 own shares representing 0.36% of its share capital, with a par value of Euros 0.50 per share and a total par value of Euros 983 thousand, and an average acquisition price of Euros 18.68 per share (at 31 December 2015 the Parent held 437,187 own shares representing 0.32% of its share capital, with a par value Euros 2 per share and a total par value of Euros 874 thousand, and an average acquisition price of Euros 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 Parent 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 Parent.

- **Profit for the year attributable to the Parent**

Profit for 2016 totals Euros 636,920 thousand (Euros 606,013 thousand at 31 December 2015).

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

The interim dividend authorised by the board of directors in 2016 has been recognised as a Euros 128,417 thousand reduction in consolidated equity at 31 December 2016 (Euros 120,082 thousand at 31 December 2015) (see note 16).



On 20 December 2016 the Parent's board of directors agreed to pay an interim dividend of Euros 0.2382 (gross) per share with a charge to 2016 profit, payable on 5 January 2017 (interim dividend of Euros 0.8906 (gross) per share, before the 4-for-1 share split, with a charge to 2015 profit).

Details of the dividends paid during 2016 and 2015 are as follows:

	2016			2015 (*)		
	<u>% of par value</u>	<u>Euros per share</u>	<u>Amount (thousands of Euros)</u>	<u>% of par value</u>	<u>Euros per share</u>	<u>Amount (thousands of Euros)</u>
Ordinary shares	160.50%	0.8025	432,834	150.00%	0.7500	404,825
	-----	-----	-----	-----	-----	-----
Total dividends paid	160.50%	0.8025	432,834	150.00%	0.7500	404,825
	=====	=====	=====	=====	=====	=====
Dividends charged to profit	160.50%	0.8025	432,834	150.00%	0.7500	404,825
	=====	=====	=====	=====	=====	=====

(*) For the purpose of comparing the Euros per share in both years, data on the Euros per share in 2015 are presented on a like-for-like basis in relation to the split performed in 2016.

The Parent's board of directors also proposed to the shareholders at their general meeting the distribution of a supplementary dividend of Euros 0.6205 per share, which would result in a total dividend for 2016 of Euros 0.8587 per share (Euros 3.21 per share in 2015, before the 4-for-1 share split).

- **Valuation adjustments**

- **Available-for-sale financial assets**

At 31 December 2016 and 2015 this item reflects valuation adjustments to available-for-sale financial assets due to fluctuations in the share price of the Group's 5% investment in the listed company Redes Energéticas Nacionais (hereinafter REN), the benchmark index for which is the Portuguese PSI 20. At 31 December 2016 this item totals Euros 16,125 thousand (Euros 15,480 thousand in 2015).

- **Hedging transactions**

This line item reflects changes in the value of derivative financial instruments.

At 31 December 2016 this item totals a negative amount of Euros 83,801 thousand (a negative amount of Euros 48,613 thousand in 2015).



○ **Translation differences and other**

This line item mainly comprises the exchange gains and losses arising from translation of the financial statements of foreign businesses, specifically the Peruvian companies TESUR, TESUR2, TESUR 3, REA and REDESUR and the Chilean companies RECH and TEN. At 31 December 2016 they amount to Euros 5,520 thousand (Euros 3,651 thousand in 2015). This increase is primarily due to the performance of the US Dollar against the Euro.

Non-controlling interests

Non-controlling interests under equity in the accompanying consolidated statement of financial position reflect the non-controlling interests in TESUR, TESUR 2 and REDESUR at 31 December 2015 and 2016. In 2016 they amount to Euros 17,495 thousand (Euros 15,350 thousand in 2015). Details of movement in 2016 are as follows:

	<u>31 December</u> <u>2015</u>	<u>Profit for the</u> <u>year</u>	<u>Net</u> <u>translation</u> <u>differences</u>	<u>31 December</u> <u>2016</u>
Non-controlling interests	15,350	1,687	458	17,495

Regarding the main non-controlling interests referred to above, a summary of the financial information on assets, liabilities and profit/loss for the year of the investees is as follows:

(In thousands of Euros)	<u>31/12/2016</u>		
	REDESUR	TESUR	TESUR 2
Non-current assets	97,632	66,805	19,803
Current assets	24,999	8,745	8,303
ASSETS	122,631	75,550	28,106
Non-current liabilities	74,125	36,338	-
Current liabilities	7,218	4,931	6,906
LIABILITIES	81,343	41,269	6,906
NET ASSETS	41,288	34,281	21,200
Income	15,636	7,041	15,040
Expenses	4,766	1,441	15,272
Gross operating profit/(loss)	10,870	5,600	(232)
Profit/(loss) after tax	3,250	645	(196)
Profit/(loss) for the year attributable to non-controlling interests	1,788	355	(122)



(In thousands of Euros)	31/12/2015		
	REDESUR	TESUR	TESUR 2
Non-current assets	97,632	67,372	19,803
Current assets	24,999	8,579	8,303
ASSETS	122,631	75,951	28,106
Non-current liabilities	74,125	38,666	-
Current liabilities	7,218	4,749	6,906
LIABILITIES	81,343	43,415	6,906
NET ASSETS	41,288	32,536	21,200
Income	14,070	6,156	3,090
Expenses	4,482	1,516	3,125
Gross operating profit/(loss)	9,588	4,640	(35)
Profit/(loss) after tax	2,621	(1,012)	68
Profit/(loss) for the year attributable to non-controlling interests	1,442	(557)	42

12. GRANTS AND OTHER

Movement in grants and other in 2016 and 2015 is as follows:

RED ELÉCTRICA GROUP								
Details of movement in grants and other non-current revenue received in advance								
2016 and 2015								
(Expressed in thousands of Euros)								
	31 December <u>2014</u>	<u>Additions</u>	<u>Applications</u>	31 December <u>2015</u>	<u>Additions</u>	<u>Disposals</u>	<u>Applications</u>	31 December <u>2016</u>
Capital grants	137,964	64,456	(7,488)	194,932	6,866	-	(8,022)	193,776
Other grants	48,842	11,031	(2,863)	57,010	10,718	(625)	(3,301)	63,802
Other non-current revenue received in advance	295,636	10,753	(9,733)	296,656	3,702	-	(9,995)	290,363
	=====	=====	=====	=====	=====	=====	=====	=====
	482,442	86,240	(20,084)	548,598	21,286	(625)	(21,318)	547,941
	=====	=====	=====	=====	=====	=====	=====	=====

Capital grants include the amounts received by REE from official bodies for the construction of electricity facilities, while other non-current revenue received in advance reflects amounts received under agreements with third parties. Applications reflect the amounts taken to profit or loss on the basis of the useful life of the corresponding facilities and recognised under non-financial and other capital grants in the consolidated income statement.

Other grants mainly comprise income tax deductions for investments in the Canary Islands, which by their nature are similar to capital grants (see note 2 c).



Applications reflect the amounts taken to profit or loss on the basis of the useful life of the assets linked to the deductions, recognised under non-financial and other capital grants in the consolidated income statement.

13. NON-CURRENT PROVISIONS

Movement in 2016 and 2015 is as follows:

RED ELÉCTRICA GROUP											
Movement in provisions											
2016 and 2015											
(Expressed in thousands of Euros)											
	31				Actuarial	31				Actuarial	31
	December	Additions	Applications	Reversals	gains and	December	Additions	Applications	Transfers	gains and	December
	<u>2014</u>				losses	<u>2015</u>				losses	<u>2016</u>
Provisions for employee benefits	67,767	6,310	(940)	-	(16,242)	56,895	4,369	(7,789)	-	2,123	55,598
Other provisions	37,755	1,125	(11,244)	(3)	-	27,633	1,364	(1,201)	11,257	-	39,053
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
	105,522	7,435	(12,184)	(3)	(16,242)	84,528	5,733	(8,990)	11,257	2,123	94,651
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

Provisions for employee benefits comprise defined benefit plans, which essentially include the future commitments – specifically medical insurance – undertaken by the Group vis-à-vis its personnel from the date of their retirement, calculated using actuarial studies carried out by an independent expert. In 2016 and 2015 additions derive mainly from the annual accrual of these commitments, as well as changes in the actuarial assumptions used. These additions have been recognised as personnel expenses or finance costs, depending on their nature, and under reserves when they derive from changes in the actuarial assumptions (mainly in the case of obligations related to medical insurance) or in profit or loss (in the case of past service obligations). The personnel expenses and finance costs recognised in this connection in the consolidated income statement for 2016 amount to Euros 1,453 thousand and Euros 1,027 thousand, respectively (Euros 1,380 thousand and Euros 1,461 thousand, respectively, in 2015), whilst the reserves recognised in 2016 totalled Euros 2,123 thousand, net of tax (a negative amount of Euros 16,242 thousand in 2015).

The assumptions made with regard to 2016 and 2015 were as follows:

	<u>2016</u>	<u>2015</u>
	<u>Actuarial assumptions</u>	<u>Actuarial assumptions</u>
Discount rate	2.10%	2.33%
Cost increase	3.0%	3.0%
Mortality table	PERM/F 2000 new production	PERM/F 2000 new production



Details of the effect of an increase/decrease of one percentage point in the cost of medical insurance are as follows:

(In thousands of Euros)	2016		2015	
	+1%	-1%	+1%	-1%
Current service cost	454	(328)	436	(314)
Interest cost of net post-employment medical costs	9	(7)	10	(7)
Accumulated post-employment benefit obligation for medical insurance	10,867	(7,959)	10,165	(7,437)

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:

(In thousands of Euros)	Discount rate		
	<u>2.10%</u>	<u>1.60%</u>	<u>Sensitivity</u>
Current service cost	983	1,191	208
Interest cost of net post-employment medical costs	905	694	(212)
Accumulated post-employment benefit obligation for medical insurance	45,400	51,245	5,845

Provisions for employee benefits at 31 December 2016 also include deferred remuneration schemes (see note 4I). At 31 December 2016 personnel expenses recognised in the income statement amount to Euros 1,889 thousand (Euros 3,469 thousand in 2015) and no finance costs have been recognised (Euros 1 thousand in 2015).

Other provisions basically include the amounts recorded by the Group every year to cover the potential unfavourable rulings relating mainly to administrative proceedings, administrative disciplinary proceedings, judicial reviews, primarily of expropriation proceedings, and out-of-court claims. The provisions recognised to cover these events are measured on the basis of the potential economic content of the ongoing appeals, litigation, claims and general legal or out-of-court proceedings to which the Group is party. In 2016, the amount of Euros 11,257 thousand shown in transfers reflects provisions for current liabilities from prior years for which the estimated settlement period has been revised to non-current.

In 2015, applications mainly relate to payment of the Euros 10 million penalty imposed by the Catalan regional government due to the disciplinary proceedings instituted as a result of the power cut in Barcelona in 2007.



14. OTHER NON-CURRENT LIABILITIES

Other non-current liabilities basically include the revenues received in advance from agreements with various telecommunications operators for the use of the telecommunications network capacity, recognised in the consolidated income statement based on the duration of the agreements, with expiry dates up to 2035, and amounting to Euros 38,579 thousand at 31 December 2016 (Euros 42,467 thousand at 31 December 2015).

This item also includes the non-current liabilities arising from the compensation paid by Électricité de France (hereinafter EDF) under the agreement signed in 1997 for the adaptation of electricity supply contracts, which amounted to Euros 23,625 thousand at 31 December 2016 (Euros 23,625 thousand at 31 December 2015). These are multi-year commitments and are therefore subject to the construction of facilities that were not completed at 31 December 2016.

15. FINANCIAL RISK MANAGEMENT POLICY

The Group's financial risk management policy establishes principles and guidelines to ensure that any significant risks that could affect the objectives and activities of the Red Eléctrica 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 Group's core value, rather than generating extraordinary profits.

The Group's finance management is responsible for managing financial risk, ensuring consistency with the Group's strategy and coordinating risk management across the various Group companies, 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.

The financial risks to which the Group is exposed are as follows:



Market risk

Market risk reflects variations in the financial markets in terms of prices, interest and exchange rates, credit conditions and other variables that could affect short-, medium- and long-term finance costs.

Market risk is managed on the borrowings to be arranged (the currency, maturity and interest rates), and through the use of hedging instruments that allow the financial structure to be modified. Market risk specifically includes:

- Interest rate risk

Interest rate fluctuations change the fair value of assets and liabilities that accrue interest at fixed rates and the future cash flows from assets and liabilities indexed to floating interest rates. The debt structure at 31 December 2016 and 2015 is as follows:

	2016		2015	
	Thousands of Euros		Thousands of Euros	
	Fixed rate	Variable rate	Fixed rate	Variable rate
Non-current issues	3,414,492	14,912	3,112,780	14,905
Non-current bank borrowings	865,840	611,582	1,020,333	582,058
Current issues	3,882	200,064	323,585	-
Current bank borrowings	79,528	10,577	52,582	186,491
Total debt	4,363,742	837,135	4,509,280	783,454
Percentage	84%	16%	85%	15%

The debt structure is low risk with moderate exposure to fluctuations in interest rates, as a result of the debt policy implemented, which aims to bring the cost of debt into line with the financial rate of return applied to the Group's regulated assets, among other objectives.

The interest rate risk to which the Group is exposed at 31 December 2016 and 2015 derives from changes in the fair value of derivative financial instruments and mostly affects equity, but not profit for the year. A sensitivity analysis of this risk is as follows (in thousands of Euros):



	Effect on consolidated equity of market interest rate fluctuations (in thousands of Euros)			
	2016		2015	
	+0.10%	-0.10%	+0.10%	-0.10%
Interest rate hedges:				
- Cash flow hedges				
Interest rate swap	6,040	(6,099)	6,002	(6,061)
Interest rate and exchange rate hedges:				
- Cash flow hedges				
Cross currency swap	(17)	14	(94)	93

This rise or decline of 0.10% in interest rates would have decreased or increased profit by Euros 1,063 thousand in 2016 and by Euros 1,314 thousand in 2015.

The fair value sensitivity has been estimated using a valuation technique based on discounting future cash flows at prevailing market rates at 31 December 2016 and 2015.

- Currency risk

Currency risk management considers transaction risk, arising on cash inflows and outflows in currencies other than the Euro, and translation risk, i.e. a company's exposure when consolidating its subsidiaries and/or assets located in countries whose functional currency is not the Euro.

With a view to reducing the currency risk on issues in the US private placements (USPP) market, the Company has arranged cash flow hedges through US Dollar/Euro cross currency swaps on the principal and interest, which cover the amount and total term of the issue up to October 2035 (see note 17).

In order to mitigate the translation risk on assets located in countries whose functional currency is not the Euro, the Group finances a portion of its investments in the functional currency. The Group has also arranged hedges of net investments in US Dollars using cross currency swaps up to January 2021 (see note 17). Consequently, had the US Dollar strengthened or weakened by 10% against the Euro at year end, the Parent's equity would have increased or decreased by approximately Euros 7 million at 31 December 2016 (Euros 2 million at 31 December 2015).

Credit risk

In light of the nature of revenues from electricity transmission and electricity system operation, and the solvency of the electricity system agents, the Red Eléctrica Group's principal activities are not significantly exposed to credit risk. For the Group's other activities, credit risk is mainly managed through instruments to reduce or limit such risk.

In any event, credit risk is managed through policies that contain certain requirements regarding counterparty credit quality, and further guarantees are requested when necessary.



At year end the Group's exposure to credit risk in connection with the fair value of its derivatives is insignificant, having entered into collateral assignment agreements with various counterparties since 2015 in order to mitigate this risk.

At 31 December, less than 1% of balances are past-due approximately (1% in 2015), although the companies do not consider there to be any risk as regards recoverability. The credit quality of the receivables is considered to be high.

Liquidity risk

Liquidity risk arises due to differences between the amounts or dates of collection and payment of the Group companies' assets and liabilities.

Liquidity risk is mostly managed by controlling the timing of financial debt and maintaining a considerable volume of available capital during the year, setting maximum limits of amounts falling due for each period defined. This process is carried out at Group company level, in accordance with the practices and limits set by the Group. The limits established vary according to the geographical area, so as to ensure that the liquidity of the market in which the companies operate is taken into account. Furthermore, the liquidity risk management policy entails preparing cash flow projections in the main currencies in which the Group operates, taking into consideration the level of liquid assets and funds available according to these projections, and monitoring the liquidity indicators as per the consolidated statement of financial position and comparing these with market requirements.

The Group's financial debt at 31 December 2016 has an average maturity of 5.7 years. Details of the maturities of bond issues and bank borrowings are provided in note 16.

The Group's liquidity position for 2016 was based on its robust capacity to generate cash flows, supported by undrawn credit facilities amounting to Euros 2,003 million (non-current and current balances of Euros 1,258 million and Euros 745 million, respectively).

Price risk

The Group is exposed to price risk relating to capital investments classified as available for sale in the consolidated statement of financial position. Investments available for sale on quoted markets basically comprise the 5% interest held by the Group in REN. At 31 December 2016 had the listed price of REN shares been 10% higher or lower, equity would have increased or decreased by approximately Euros 5 million, respectively (Euros 6 million in 2015).

16. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets

Details of the Red Eléctrica Group's current and non-current financial assets at 31 December 2016 and 2015 are as follows:



Current period (in thousands of Euros)

	<u>Available- for-sale financial assets</u>	<u>Loans and receivables (1)</u>	<u>Hedging derivatives</u>	<u>Total</u>
Equity instruments	74,288	-	-	74,288
Derivatives	-	-	28,742	28,742
Other financial assets	-	8,831	-	8,831
	=====	=====	=====	=====
Non-current	74,288	8,831	28,742	111,861
	=====	=====	=====	=====
Derivatives	-	-	-	-
Other financial assets	-	40,575	-	40,575
	-----	-----	-----	-----
Current	-	40,575	-	40,575
	=====	=====	=====	=====
Total	74,288	49,406	28,742	152,436
	=====	=====	=====	=====

Prior period (in thousands of Euros)

	<u>Available- for-sale financial assets</u>	<u>Loans and receivables (1)</u>	<u>Hedging derivatives</u>	<u>Total</u>
Equity instruments	78,845	-	-	78,845
Derivatives	-	-	35,655	35,655
Other financial assets	-	5,486	-	5,486
	=====	=====	=====	=====
Non-current	78,845	5,486	35,655	119,986
	=====	=====	=====	=====
Derivatives	-	-	-	-
Other financial assets	-	2,522	-	2,522
	-----	-----	-----	-----
Current	-	2,522	-	2,522
	=====	=====	=====	=====
Total	78,845	8,008	35,655	122,508
	=====	=====	=====	=====

(1) Excluding trade receivables



- **Equity instruments**

Equity instruments essentially comprise the 5% interest held by the Group in REN, a holding company that encompasses the operation and use of electricity transmission assets and various gas infrastructure in Portugal. This interest was acquired in 2007 for Euros 98,822 thousand. In the latter part of 2015 the Parent contributed the interest it held in REN to REI.

At 31 December 2015 REN's consolidated equity totals Euros 1,161,289 thousand and the profit after tax amounts to Euros 110,311 thousand.

The value of this investment is subject to the listed share price. In 2016 the fair value of this equity instrument decreased and the corresponding valuation adjustment was recognised directly under equity.

At 31 December 2016 and 2015 the Company has calculated the decrease in value of this investment at Euros 2,242 thousand, which has been recognised in equity (a Euros 10,039 thousand increase in 2015).

In 2016 and 2015 there was no objective evidence of impairment of the investment in REN.

This item also comprises the investment in economic interest groups (EIGs), measured at Euros 1,765 thousand (Euros 4,435 thousand in 2015). These EIGs engage in the lease of assets operated by an unrelated party, which retains most of the risks and rewards of the activity, while the Group only avails of the tax benefits pursuant to Spanish legislation. The Company recognises the tax losses incurred by these EIGs against the investments, together with the corresponding finance income (see note 21 d) reflecting the difference compared to income tax payable to the taxation authorities.

- **Derivatives**

Details of derivative financial instruments are provided in note 17.

- **Other financial assets**

The balance at 31 December 2016 mainly comprises the loan of Euros 32,172 thousand extended to the associate TEN, which earns interest at a Libor-pegged rate plus 270 b.p., and guarantees and loans extended by REE to its personnel, which fall due in the long term. There are no significant differences between the fair value and the carrying amount at 31 December 2016 and 2015.



Fair value hierarchy levels

Details of the Group's financial assets measured at fair value using the inputs defined for this calculation at 31 December 2016 and 2015 are as follows:

	Current period (in thousands of Euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total balance</u>
Equity instruments	72,037	-	2,251	74,288
Derivatives	-	28,742	-	28,742
Other financial assets	-	-	49,406	49,406
	Prior period (in thousands of Euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total balance</u>
Equity instruments	74,279	-	4,566	78,845
Derivatives	-	35,655	-	35,655
Other financial assets	-	-	8,008	8,008

Level 1 equity instruments reflect the 5% interest held by the Group in the listed company REN.

Financial liabilities

Details of the Red Eléctrica Group's current and non-current financial liabilities at 31 December 2016 and 2015 are as follows:



	Current period (thousands of Euros)		
	<u>Debts and payables (1)</u>	<u>Hedging derivatives and others</u>	<u>Total</u>
Loans and borrowings	1,477,422	-	1,477,422
Bonds and other marketable securities	3,483,134	-	3,483,134
Derivatives	-	73,620	73,620
Other financial liabilities (2)	-	224	224
Non-current	4,960,556	73,844	5,034,400
Loans and borrowings	103,168	-	103,168
Bonds and other marketable securities	280,876	-	280,876
Derivatives	-	-	-
Other financial liabilities	682,865	-	682,865
Current	1,066,909	-	1,066,909
Total	6,027,689	73,620	6,101,309
	=====	=====	=====
	Prior period (thousands of Euros)		
	<u>Debts and payables (1)</u>	<u>Hedging derivatives and othera</u>	<u>Total</u>
Loans and borrowings	1,602,391	-	1,602,391
Bonds and other marketable securities	3,168,450	-	3,168,450
Derivatives	-	56,048	56,048
Other financial liabilities	-	224	224
Non-current	4,770,841	56,272	4,827,113
Loans and borrowings	247,287	-	247,287
Bonds and other marketable securities	400,869	-	400,869
Derivatives	-	671	671
Other financial liabilities	664,501	-	664,501
Current	1,312,657	671	1,313,328
Total	6,083,722	56,719	6,140,441
	=====	=====	=====

(1) Excluding trade payables

(2) Reflects non-current guarantees and deposits received



- **Loans and borrowings, bonds and other marketable securities**

The carrying amount and fair value of loans and borrowings and issues of bonds and other marketable securities at 31 December 2016 and 2015 are as follows:

	Carrying amount		Fair value	
	Thousands of Euros		Thousands of Euros	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Issues in Euros	3,180,848	2,998,351	3,445,378	3,256,816
Issues in US Dollars	506,232	493,684	601,740	590,287
Bank borrowings in Euros	1,527,879	1,841,464	1,551,109	1,825,363
Bank borrowings in foreign currency	39,648	-	39,647	-
	-----	-----	-----	-----
Total	5,254,607	5,333,499	5,637,874	5,672,466
	=====	=====	=====	=====

The fair value of all loans and borrowings and issues of bonds and other marketable securities has been estimated using valuation techniques based on discounting future cash flows at market rates prevailing at each date (fair value hierarchy Level 2).

At 31 December 2016 the accrued interest payable amounts to Euros 89,993 thousand (Euros 85,498 thousand in 2015).

Issues in Euros at 31 December 2016 include:

- Eurobonds issued by Red Eléctrica Financiaciones, S.A.U. (hereinafter REF) totalling Euros 2,980,784 thousand (Euros 2,998,351 thousand in 2015). One bond issue amounting to Euros 300 million was carried out in 2016 (two bond issues amounting to Euros 500 million and Euros 75 million in 2015).
- Promissory notes issued on the Euromarket by REF as part of the “Euro Commercial Paper Programme” (ECP Programme) which fall due in the short term and amount to Euros 200,064 thousand (with no outstanding balance at 31 December 2015).

Issuance in US Dollars at 31 December 2016 amounts to Euros 506,232 thousand (Euros 493,684 thousand in 2015), comprising a US Dollars 500 million issue on the US private placement (USPP) market, of which US Dollars 70 million were redeemed in 2015, as well as two US Dollar bond issues made in 2015 in Peru for a total of US Dollars 110 million, of which US Dollars 103.8 million is payable at 31 December 2016 (see note 15 for an analysis of currency risk).

Bank borrowings in Euros at 31 December 2016 include non-current loans and credit facilities totalling Euros 1,382,653 thousand (Euros 1,606,864 thousand in 2015) and a



syndicated credit facility amounting to Euros 145,226 thousand (Euros 234,600 thousand in 2015).

Details of the maturities of bond issues and bank borrowings at 31 December 2016 are as follows:

RED ELÉCTRICA GROUP								
Details of maturity of bond issues and bank borrowings								
at 31 December 2016								
(Expressed in thousands of Euros)								
Thousands of Euros								
	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>Subsequent</u> <u>years</u>	<u>Valuation</u> <u>adjustments</u>	<u>Total</u>
Issues in Euros	200,070	599,400	284,100	550,000	-	1,590,000	(42,722)	3,180,848
Issues in US Dollars	3,914	4,117	4,331	175,318	4,792	314,301	(541)	506,232
Bank borrowings in Euros	90,281	96,823	96,419	104,793	353,420	789,281	(3,138)	1,527,879
Bank borrowings in US Dollars	139	39,509	-	-	-	-	-	39,648
	-----	-----	-----	-----	-----	-----	-----	-----
	294,404	739,849	384,850	830,111	358,212	2,693,582	(46,401)	5,254,607
	=====	=====	=====	=====	=====	=====	=====	=====

The average interest rate was 2.94% in 2016 (3.20% in 2015).

At 31 December 2016 Group companies have undrawn credit facilities amounting to Euros 2,003 million, of which Euros 1,258 million expire in the long term (Euros 1,313 million at 31 December 2015) and Euros 745 million in the short term (Euros 612 million at 31 December 2015).



Details of bonds and other marketable securities at 31 December 2016 and 2015 are as follows:

The outstanding balance at 31 December 2016 and 2015 of debt securities requiring a prospectus to be filed relates to issues registered in Dublin and Luxembourg.

- **Derivatives**

Details of derivative financial instruments are provided in note 17.

- **Other current financial liabilities**

Details of other current financial liabilities at 31 December 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Dividend payable	128,417	120,082
Suppliers of fixed assets and other payables	327,251	277,468
Other payables	227,197	267,622
	-----	-----
	682,865	665,172
	=====	=====

Suppliers of fixed assets essentially reflect balances incurred on the construction of electricity facilities.

	Current period (thousands of Euros)				
	<u>Opening outstanding balance at 31/12/2015</u>	<u>(+) Issues</u>	<u>(-) Repurchases or repayments</u>	<u>(+/-) Exchange rate and other adjustments</u>	<u>Closing outstanding balance at 31/12/2016</u>
Debt securities requiring a prospectus to be filed	2,998,351	838,121	(660,467)	4,843	3,180,848
Debt securities not requiring a prospectus to be filed	-	-	-	-	-
Other debt securities issued outside EU member states	493,684	-	(2,668)	15,216	506,232
	-----	-----	-----	-----	-----
Total	3,492,035	838,121	(663,135)	20,059	3,687,080
	=====	=====	=====	=====	=====

	Prior period (thousands of Euros)				
	<u>Opening outstanding balance at 31/12/2014</u>	<u>(+) Issues</u>	<u>(-) Repurchases or repayments</u>	<u>(+/-) Exchange rate and other adjustments</u>	<u>Closing outstanding balance at 31/12/2015</u>
Debt securities requiring a prospectus to be filed	3,152,791	828,912	(987,098)	3,746	2,998,351
Debt securities not requiring a prospectus to be filed	-	-	-	-	-
Other debt securities issued outside EU member states	411,590	102,698	(59,347)	38,743	493,684
	-----	-----	-----	-----	-----
Total	3,564,381	931,610	(1,046,445)	42,489	3,492,035
	=====	=====	=====	=====	=====



Other payables basically comprise items pending settlement with respect to the Spanish electricity system and security deposits received.

Fair value hierarchy levels

Details of Group financial liabilities not included under the headings of loans and borrowings or bonds and other marketable securities measured at fair value using the inputs defined for this calculation at 31 December 2016 and 2015 are as follows:

	Current period (in thousands of Euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total balance</u>
Derivatives	-	73,844	-	73,844
Other financial liabilities	-	-	39,620	39,620
	Prior period (in thousands of Euros)			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total balance</u>
Derivatives	-	56,719	-	56,719
Other financial liabilities	-	-	41,217	41,217

Level 2 comprises foreign currency and interest rate derivatives. Level 3 comprises security deposits extended to the Group. There are no significant differences between the fair value and the carrying amount at 31 December 2016 and 2015. Liabilities at amortised cost are not disclosed by fair value hierarchy level.

17. DERIVATIVE FINANCIAL INSTRUMENTS

In line with its financial risk management policy, the Red Eléctrica Group has arranged two types of derivative financial instruments: interest rate swaps and cross currency swaps. Interest rate swaps consist of exchanging debt at variable interest rates for debt at fixed rates, in a swap where the future cash flows to be hedged are the interest payments. Similarly, cross currency swaps allow fixed- or variable-rate debt in US Dollars to be exchanged for fixed- or variable-rate debt in Euros, thereby hedging future interest and capital flows in US Dollars.

As regards the measurement of derivative financial instruments and hedging transactions disclosed in these notes, the adoption of IFRS 13 (see note 4 n) entails an adjustment to the valuation techniques used to calculate the fair value of derivative financial instruments. The Group has incorporated a credit risk adjustment to reflect own and counterparty risk in the fair value of derivative financial instruments using generally accepted measurement models.



To eliminate the credit risk from the cross currency swaps arranged to hedge the exchange rate for USPP issuance, collateral assignment agreements entailing collateral swaps were entered into with the counterparties in 2015.

When determining the credit risk adjustment for other derivatives, the Group 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 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.

Based on the fair value hierarchy levels detailed in note 4, the Company has considered that the majority of the inputs used to determine the fair value of derivative financial instruments are categorised within Level 2, including the data used to calculate the own and counterparty credit risk adjustment.

The Company has observed that the impact of using Level 3 inputs for the overall measurement of derivative financial instruments is not significant. Consequently, the Company has determined that the entire derivative financial instrument portfolio can be categorised within Level 2 of the fair value hierarchy.

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

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



	Principal	Maturity	Thousands of Euros				Thousands of Euros			
			2016		2015		2015		2015	
			Non-current		Current		Non-current		Current	
			Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate hedges:										
-Cash flow hedges:										
Interest rate swap	Euros 75,000 thousand	Up to 2016	-	-	-	-	-	-	-	(671)
Interest rate swap	Euros 330,000 thousand	Up to 2020	-	(40,937)	-	-	-	(48,036)	-	-
Interest rate swap	Euros 73,920 thousand (*)	Up to 2021	-	(1,663)	-	-	-	(1,048)	-	-
Interest rate swap	Euros 160,000 thousand	Up to 2023	-	-	-	-	326	(1,440)	-	-
Interest rate swap	Euros 140,000 thousand	Up to 2025	-	(8,822)	-	-	-	(3,136)	-	-
Interest rate swap	Euros 500,000 thousand (*)	Up to 2026	-	(17,684)	-	-	4,519	(2,388)	-	-
Exchange rate hedge:										
-Hedges of a net investment:										
Cross currency swap	US Dollars 150,000 thousand	Up to 2021	-	(4,514)	-	-	-	-	-	-
Interest rate and exchange rate hedges:										
-Cash flow hedges:										
(Cross currency swap)	US Dollars 430,000 thousand	Up to 2035								
Interest rate hedge			(24,988)	-	-	-	(9,955)	-	-	-
Exchange rate hedge			53,730	-	-	-	40,765	-	-	-
			28,742	(73,620)	-	-	35,655	(56,048)	-	(671)
			=====	=====	=====	=====	=====	=====	=====	=====

(*) Euros 81,480 thousand in 2015. Reduced by Euros 7,560 thousand in 2016.

(**) Euros 300,000 thousand in 2015. Swaps amounting to Euros 300,000 thousand were arranged in 2016, of which Euros 100 thousand was cancelled.

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

	Principal	Maturity	Thousands of Euros						Total
			2017	2018	2019	2020	2021	2022 and thereafter	
Interest rate hedges:									
-Cash flow hedges:									
Interest rate swap	Euros 330,000 thousand	Up to 2020	-	-	-	(40,937)	-	-	(40,937)
Interest rate swap	Euros 73,920 thousand	Up to 2021	-	-	-	-	(1,663)	-	(1,663)
Interest rate swap	Euros 140,000 thousand	Up to 2025	-	-	-	-	-	(8,822)	(8,822)
Interest rate swap	Euros 500,000 thousand	Up to 2026	-	-	-	-	-	(17,684)	(17,684)
Exchange rate hedge:									
-Hedges of a net investment:									
Cross currency swap	US Dollars 150,000 thousand	Up to 2021	-	-	-	-	(4,514)	-	(4,514)
Interest rate and exchange rate hedges:									
-Cash flow hedges: (cross currency swap)									
Interest rate hedge	US Dollars 430,000 thousand	Up to 2035	-	-	-	(4,281)	-	(20,707)	(24,988)
Exchange rate hedge			-	-	-	22,492	-	31,238	53,730
			-	-	-	(22,726)	(6,177)	(15,975)	(44,878)
			=====	=====	=====	=====	=====	=====	=====



18. TRADE AND OTHER PAYABLES

Details of trade and other payables at 31 December 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Suppliers	301,272	402,334
Other payables	19,787	74,672
Current tax liabilities (note 20)	14,046	6,276
	-----	-----
	335,105	483,282
	=====	=====

Suppliers essentially reflect payables arising from repairs and maintenance work and modifications to electricity facilities, as well as balances pending settlement vis-à-vis Spanish electricity system agents.

Other payables in 2015 basically comprised balances with public entities, for the most part value added tax (VAT) on the latest regulated remuneration settlements announced by the Spanish National Markets and Competition Commission (CNMC) each year.

19. 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.

The scope of this resolution also extends to trading companies that prepare consolidated annual accounts, although only with respect to fully consolidated subsidiaries or equity-accounted investees registered in Spain, irrespective of the financial reporting framework under which the accounts are prepared.

In accordance with the resolution, which applies to annual accounts for years beginning on or after 1 January 2015, the information concerning late payments to suppliers for 2016 and 2015 is as follows:



(In days)	2016	2015
Average supplier payment period	46.2	50.1
Transactions paid ratio	47.5	51.1
Transactions payable ratio	15.8	15.9

(Thousands of Euros)	2016	2015
Total payments made	384,927	404,854
Total payments outstanding	16,762	12,794

20. TAXATION

The tax group headed by Red Eléctrica Corporación, S.A. has filed consolidated tax returns in Spain since 2002. At 31 December 2016, the tax group includes the Parent, REE, REI, REF, REINTEL and REINCAN.

Companies that do not form part of the tax group are subject to the legislation applicable in their respective countries.

A reconciliation of the prevailing tax rate in Spain with the tax rate applicable to the Group is as follows:



	Thousands of Euros	
	2016	2015
Consolidated accounting profit for the year before tax	850,788	829,722
Permanent differences and consolidation adjustments	(17,495)	(26,906)
Consolidated taxable accounting income	833,293	802,816
	=====	=====
Tax rate	25%	28%
Profit multiplied by tax rate	208,323	224,788
Effect of applying different tax rates	1,623	643
Tax calculated at the tax rate of each country	209,946	225,431
Deductions	(1,419)	(2,392)
Income due to changes in tax rate (Law 27/2014)	-	(3,001)
Income tax adjustments	3,654	2,924
	-----	-----
Income tax	212,181	222,962
Current income tax	224,069	208,296
Deferred income tax	(11,888)	14,666
	=====	=====
Effective tax rate	24.94%	26.87%
	-----	-----

The effective rate of income tax is primarily influenced by permanent differences, deductions and changes in the tax rate. The difference between the effective rates for 2016 and 2015 is primarily due to the reduction in the general income tax rate in Spain from 28% in 2015 to 25% in 2016.

Permanent differences in 2016 and 2015 primarily 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 an entity of the tax group (see note 11).

Deductions mainly comprise those for research, development and technological innovation expenditure, as well as international double taxation relief.



Given the financial nature of the deduction for investments in fixed assets in the Canary Islands, it is treated as a grant, and its impact on the income statement is deferred over several years based on the useful lives of the assets for which it was awarded (see note 4j).

Deductions recognised as grants in 2016 amount to Euros 3,301 thousand (Euros 2,863 thousand in 2015) and the amount still to be recognised at 31 December 2016 is Euros 63,802 thousand (Euros 57,010 thousand in 2015).

Current receivables from and payables to public entities at 31 December 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Current receivables		
Recoverable VAT	7,372	2,873
Recoverable income tax	3,694	2,458
Other recoverable taxes	875	319
Current payables		
VAT payable	594	60,063
Other taxes payable	4,726	4,362
Income tax payable	14,046	6,276

In 2016 and 2015, adjustments were made to taxable income to reflect recognition of the EIGs in which the Group has interests, amounting to Euros 46,075 thousand and Euros 34,798 thousand, respectively.

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



	Thousands of Euros <u>2016</u>		Thousands of Euros <u>2015</u>	
	<u>Income statement</u>	Income and expense recognised directly <u>in equity</u>	<u>Income statement</u>	Income and expense recognised directly <u>in equity</u>
	<u>Increases</u>	<u>Increases</u>	<u>Increases</u>	<u>Increases</u>
Deferred tax assets:				
Originating in prior years	100,758	21,617	112,365	32,574
Movement in the year	(8,657)	10,506	(11,410)	(10,957)
Adjustments due to change in tax rate (Law 27/2014)	-	-	(197)	-
Total deferred tax assets	92,101 =====	32,123 =====	100,758 =====	21,617 =====
Deferred tax liabilities:				
Originating in prior year	582,303	22,247	579,244	17,341
Movement in the year	(20,545)	(2,114)	6,257	4,906
Adjustments due to change in tax rate (Law 27/2014)	-	-	(3,198)	-
Total deferred tax liabilities	561,758 =====	20,133 =====	582,303 =====	22,247 =====

Deferred tax assets and liabilities at 31 December 2016 and 2015 are as follows:



	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Grants	787	838
Financial derivatives	26,180	16,204
Retirement and commitments with personnel	16,565	15,251
Tax loss carryforwards	1,899	994
Balance revaluations, Law 16/2012	27,986	31,308
Limit on deductible amortisation / depreciation, Law 16/2012	41,941	50,147
Other	8,866	7,633
	-----	-----
Total deferred tax assets	124,224	122,375
	=====	=====
Accelerated depreciation	535,492	553,580
Non-deductible assets	19,422	23,027
Other	26,977	27,943
	-----	-----
Total deferred tax liabilities	581,891	604,550
	=====	=====

In the consolidated statement of financial position the Group has offset deferred tax assets and deferred tax liabilities arising from the Spanish tax group in an amount of Euros 95,321 thousand, as permitted by IAS 12 (Euros 92,264 thousand in 2015).

The deferred tax assets and liabilities are expected to be recovered and settled as follows:

31/12/2016	Total	Less than 1 year	More than 1 year
Deferred tax assets	124,224	9,023	115,201
Deferred tax liabilities	581,891	23,173	558,715

The recovery/settlement of the Group's deferred tax assets/liabilities is dependent on certain assumptions, which could change.

Deferred tax assets 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. This item also comprises amounts relating to changes in value of cash flow hedges and long-term employee benefits.



Deferred tax liabilities essentially relate to the accelerated depreciation for tax purposes of certain fixed assets and the inclusion of the assets and liabilities of REDALTA and INALTA, the companies absorbed by REC in 2006. In 2016, deferred tax liabilities for accelerated depreciation as provided for in the 11th additional provision of Royal Legislative Decree 4/2004, and the 34th transitional provision of Income Tax Law 27/2014, amounted to Euros 477,592 thousand (Euros 495,641 thousand in 2015).

The notes to REC's annual accounts for 2006 contain disclosures on the merger by absorption of REDALTA and INALTA, as required by article 86 of Law 27/2014. The notes to the 2008 annual accounts include disclosures on REC's contribution to REE 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 of REC and REINTEL for 2015 also include the disclosures stipulated in article 86 of Law 27/2014 regarding the spin-off of the telecommunications services business from REI to REINTEL, while the notes to the annual accounts of REC and REI for 2015 contain the disclosures regarding the non-monetary contribution of shares in REN.

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.

Therefore, in general, Group companies in Spain have open to inspection by the taxation authorities all applicable taxes since 2013. However, this period may be different for Group companies that are subject to other tax legislation.

In July 2016 the taxation authorities initiated partial inspections of several Spanish Group companies in respect of corporate income tax for 2011 to 2014 and withholdings of personal income tax for 2012 to 2013. These inspections are still ongoing at the 2016 year end.

Inspections in Peru have resulted in tax assessments that have been appealed. The Group considers it reasonably probable that these appeals will be successful.

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, any additional liabilities that could eventually arise therefore are not expected to have a significant impact on the Company's future consolidated profit and loss.

21. INCOME AND EXPENSES

a) Revenue

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



	Thousands of Euros	
	<u>Current period</u>	<u>Prior period</u>
Domestic market	1,878,751	1,898,275
International market	53,592	40,664
a) European Union	20,352	20,013
b) OECD countries	-	-
c) Other countries	33,240	20,651
TOTAL	----- 1,932,343 =====	----- 1,938,939 =====

Domestic market essentially includes the regulated revenue from transmission and electricity system operation services in Spain, which is set each year by the Ministry of Industry, Energy and Tourism, amounting to Euros 1,737,315 thousand in 2016 (Euros 1,730,709 thousand in 2015), as well as revenue from facilities that entered into service in the prior year. It also includes telecommunications revenue totalling Euros 85,959 thousand (Euros 82,947 thousand at 31 December 2015).

International market in 2016 and 2015 mostly reflects revenue from the rendering of transmission services in the Peruvian companies, generated by operating facilities and facility construction, as well as income from reinsurance services.

b) Supplies and other operating expenses

Details of supplies and other operating expenses in 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Supplies	49,222	47,865
Other operating expenses	313,589	326,237
	----- 362,811 =====	----- 374,102 =====

Supplies and other operating expenses mainly comprise repair and maintenance costs incurred at technical electricity facilities as well as IT, advisory, leasing and other services.



c) Personnel expenses

Details of personnel expenses in 2016 and 2015 are as follows:

	Thousands of Euros	
	<u>2016</u>	<u>2015</u>
Salaries, wages and other remuneration	109,786	105,832
Social Security	23,418	23,316
Contributions to pension funds and similar obligations	1,888	1,807
Other items and employee benefits	10,053	8,680
	-----	-----
	145,145	139,635
	=====	=====

Salaries, wages and other remuneration include the remuneration of employees and members of the board of directors, termination benefits and the accrual of deferred remuneration.

The Group companies have capitalised personnel expenses (see notes 6 and 7) totalling Euros 32,756 thousand at 31 December 2016 (Euros 15,816 thousand at 31 December 2015).

- **Workforce**

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

	<u>2016</u>	<u>2015</u>
Management	131	128
Senior technicians and middle management	525	524
Technicians	576	575
Specialist and administrative staff	532	528
	-----	-----
	1,765	1,755
	=====	=====

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



	2016			2015		
	Male	Female	Total	Male	Female	Total
Management	107	27	134	106	25	131
Senior technicians and middle management	343	187	530	347	184	531
Technicians	485	93	578	483	91	574
Specialist and administrative staff	422	109	531	420	107	527
	-----	-----	-----	-----	-----	-----
	1,357	416	1,773	1,356	407	1,763
	=====	=====	=====	=====	=====	=====

The average number of employees with a disability rating of 33% or higher in 2016 and 2015, distributed by gender and category, is as follows:

	2016			2015		
	Male	Female	Total	Male	Female	Total
Management	-	-	-	-	-	-
Senior technicians and middle management	2	2	4	2	2	4
Technicians	5	-	5	5	-	5
Specialist and administrative staff	3	1	4	3	1	4
	-----	-----	-----	-----	-----	-----
	10	3	13	10	3	13
	=====	=====	=====	=====	=====	=====

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).

d) Finance income and costs

Finance income mainly comprises the dividends received on the Company's 5% interest in REN, amounting to Euros 4,566 thousand. This item also includes Euros 1,678 thousand of finance income (Euros 1,255 thousand in 2015) on the investments in EIGs (see notes 16 and 20) and Euros 4,389 thousand of finance income on the loans extended to TEN (see note 22).

Finance costs basically reflect borrowing costs on loans and borrowings, net of any amounts capitalised, as well as bonds and other marketable securities for an amount of Euros 169,550 thousand (see note 16). Capitalised borrowing costs totalled Euros 7,547 thousand in 2016 (Euros 13,475 thousand in 2015).



e) Impairment and gains/losses on disposal of financial instruments

At 31 December 2015 this item reflected a loss of Euros 730 thousand following the decision to dispose of interests in a number of entities.

22. TRANSACTIONS WITH ASSOCIATES AND RELATED PARTIES

a) Balances and transactions with associates

The Group has had an associate, TEN, since 27 January 2016. All transactions with associates have been carried out at market prices. The main transactions carried out by Group companies with equity-accounted investees in 2016 were as follows:

	RED ELÉCTRICA GROUP			
	Balances and transactions with associates			
	in the years ended 31 December 2016 and 2015			
	(Expressed in thousands of Euros)			
	2016			
	Balances		Transactions	
	Receivable	Payable	Expenses	Income
Transmisora Eléctrica del Norte, S.A. (TEN)	32,172	2	2	4,389
	-----	-----	-----	-----
Total	32,172	2	2	4,389
	=====	=====	=====	=====

b) Related party transactions

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



<u>2016</u>					
EXPENSES AND INCOME:	<u>Significant shareholders</u>	<u>Directors and management</u>	<u>Group employees, companies or entities</u>	<u>Other related parties</u>	<u>Total</u>
Leases	-	-	2	-	2
Services received	-	-	-	126	126
Other expenses	-	-	-	16,436	16,436
	-----	-----	-----	-----	-----
EXPENSES	-	-	2	16,562	16,564
	=====	=====	=====	=====	=====
Finance income	-	-	4,389	66	4,455
	-----	-----	-----	-----	-----
INCOME	-	-	4,389	66	4,455
	=====	=====	=====	=====	=====
OTHER TRANSACTIONS					
Financing agreements, loans and capital contributions (lender)	-	-	32,172	-	32,172
Other transactions	-	-	-	-	-
	-----	-----	-----	-----	-----
OTHER TRANSACTIONS	-	-	-	-	-
	=====	=====	=====	=====	=====
<u>2015</u>					
EXPENSES AND INCOME:	<u>Significant shareholders</u>	<u>Directors and management</u>	<u>Group employees, companies or entities</u>	<u>Other related parties</u>	<u>Total</u>
Management or cooperation agreements	-	-	-	-	-
Other expenses	-	-	-	9	9
	-----	-----	-----	-----	-----
EXPENSES	-	-	-	9	9
	=====	=====	=====	=====	=====
Dividends received	-	-	-	-	-
Other income	-	-	-	2	2
	-----	-----	-----	-----	-----
INCOME	-	-	-	2	2
	=====	=====	=====	=====	=====
OTHER TRANSACTIONS					
Other transactions	-	-	-	-	-
	-----	-----	-----	-----	-----
OTHER TRANSACTIONS	-	-	-	-	-
	=====	=====	=====	=====	=====



Transactions with Group employees, companies or entities comprise those with Transmisora Eléctrica del Norte (TEN) described in section a) of this note. The balance under financing agreements, loans and capital contributions (lender) at 31 December 2016 reflects the amount receivable in respect of the credit facility extended to TEN, of which a maximum of Euros 190 million was drawn down during the year.

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.

Subsequently, 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 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 pursuant to the agreements adopted by the shareholders at their general meetings on 17 July 2015 and 15 April 2016, such that it is commensurate with having assumed all executive duties of the Company. 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 employment legislation in force.

Annual variable remuneration is set by the Appointments and Remuneration Committee of the Parent 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 Parent's board of directors in 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
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 general shareholders meeting in 2016.

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 and by components and directors, is as follows:

	<u>Fixed</u> remuneration	<u>Variable</u> remuneration	<u>Allowances</u> <u>for attending</u> <u>board</u> <u>meetings</u>	<u>Committee</u> <u>work</u>	<u>Chairperson</u> <u>of committee</u> <u>or board and</u> <u>coordinating</u> <u>independent</u> <u>director</u>	<u>Other</u> 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 Andrés	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 Fernández 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 Higuera	131	0	16	28	15	0	190	155
Mr Jose Angel Partearroyo Martín ⁽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 Parent'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 extended 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 Group 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 Group directors. These policies cover the Group's directors and senior management and the premiums amount to Euros 144 thousand, inclusive of tax, in 2016 (Euros 147 thousand at 31 December 2015). These premiums are calculated based on the nature of the Group'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 or Group companies, either directly or through intermediaries, other than ordinary operations under market conditions.

24. REMUNERATION OF SENIOR MANAGEMENT

In 2016 total remuneration accrued by senior management personnel amounted to Euros 731 thousand (Euros 740 thousand in 2015) and is recognised as personnel expenses in the consolidated income statement. These amounts include the variable annual remuneration accrued on a straight-line basis, on the assumption that the objectives set each year were met. After the fulfilment of these objectives has been assessed, the variable remuneration, adjusted to the actual fulfilment rate, is paid in the opening months of the following year.

The senior management personnel who have rendered services for the Group during 2016 and 2015 are as follows:



Name	Position
Carlos Collantes Pérez - Ardá	General Manager of Transmission (1)
Eva Pagán Díaz	General Manager of Transmission (2)
Andrés Seco García	General Manager of Operations (3)
Miguel Duvison García	General Manager of Operations (2)

(1) Position held until 26 November 2015. He held the position of Assistant General Manager from that date until 31 March 2016, whereupon he left the Group.

(2) Position held since 26 November 2015.

(3) Left the Group on 18 November 2015.

Euros 16 thousand of the total remuneration accrued by these senior managers consisted of contributions to life insurance and pension plans (Euros 13 thousand in 2015).

No advances or loans have been extended to these senior managers at 31 December 2016 and 2015.

As a result of the work of the Parent'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, which includes the senior management personnel.

Fulfilment of this remuneration scheme 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.

The contracts in place with serving senior management personnel do not include guarantee or golden parachute clauses, in the event of dismissal. In the event the employment relationship were terminated, the indemnity to which senior management personnel would be entitled would be calculated in accordance with applicable legislation. The contracts for these executives have been approved by the Appointments and Remuneration Committee and the board of directors has received notice thereof.

Senior management personnel who rendered services in the Group as at 31 December 2016 are included in the Structural Management Plan implemented by the Company in 2015.

At 31 December 2016 and 2015 the Group has taken out civil liability insurance to cover claims from third parties in respect of possible damage and loss caused by actions or omissions in performing duties as senior management of the Group. These policies cover all the Group's directors and senior management and the premiums amount to Euros 144 thousand, inclusive of tax, in 2016 (Euros 147 thousand in 2015). These premiums are calculated based on the nature of



the Group's activity and its financial indicators, thus they cannot be broken down individually or allocated to directors and senior management separately.

In 2016 expenses of Euros 823 thousand were recognised in relation to a senior manager leaving the Group. In 2015 expenses of Euros 914 thousand were recognised in relation to a senior manager leaving the Group.

25. SEGMENT REPORTING

The principal activity of the Red Eléctrica Group is electricity transmission and operation of the electricity system in Spain, carried out through REE, which represents 92% of consolidated revenue and 92% of the Group's total assets (93% and 94%, respectively, in 2015). Other activities account for the remaining 8% of revenue and 8% of total assets (7% and 6%, respectively, in 2015). Consequently, the Group did not consider it necessary to provide information by activity or geographical segment.

26. INVESTMENTS IN JOINT ARRANGEMENTS

The Group, through REE, and Réseau de Transport d'Électricité (RTE), the French transmission system operator, each hold a 50% investment in the INELFE joint arrangement, which has its registered office in Paris. Its statutory activity is the study and execution of interconnections between Spain and France that will increase the electricity exchange capacity between the two countries. Decisions are taken with the unanimous consent of the parties. RTE and REE both have rights to the assets and obligations for the liabilities of INELFE. The joint arrangement has therefore been classified as a joint operation.

The Group recognises the assets, including its interest in the jointly controlled assets, and the liabilities, including its share of the liabilities that have been incurred jointly in INELFE, in its consolidated annual accounts.

In view of the existence of contractual agreements under which decisions on relevant activities require the unanimous consent of both parties, the Group also has joint control of a "UTE" (*Unión Temporal de Empresas* – a form of temporary business association). The Group has classified the investments as joint operations because the parties have rights to the assets and obligations for the liabilities. The UTE has been formed to provide a dark fibre link, with an availability guarantee, between the Balearic Islands and the Mediterranean Coast of the Spanish mainland.

27. GUARANTEES AND OTHER COMMITMENTS WITH THIRD PARTIES AND OTHER CONTINGENT ASSETS AND LIABILITIES

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 Red Eléctrica de España Finance, B.V. (RBV) (US Dollars 430 million in 2015), and REF's Eurobonds programme for an amount of up to Euros 4,500 million at 31 December 2016 (Euros 4,500 million in 2015).



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.

On 19 February 2015, REDESUR, TESUR and Scotia Sociedad Titulizadora S.A. created a securitisation trust to hold the REDESUR-TESUR trust assets, in order to back the obligations arising from the US Dollar 110 million bond issue.

At 31 December 2016 the Group has extended bank guarantees to third parties in relation to its normal business operations, amounting to Euros 127,956 thousand (Euros 46,481 thousand in 2015).

28. ENVIRONMENTAL INFORMATION

During 2016 Group companies incurred ordinary expenses of Euros 19,804 thousand in protecting and improving the environment (Euros 18,957 thousand in 2015), essentially due to the implementation of environmental initiatives aimed at protecting biodiversity, fire prevention, slowing climate change, minimising pollution and safeguarding the countryside.

In 2016 environmental impact and monitoring studies were also carried out in relation to newly-constructed electricity facilities. The costs incurred in these studies amounted to Euros 4,469 thousand (Euros 3,923 thousand in 2015).

The Group companies are not involved in any litigation relating to environmental protection or improvement that could give rise to significant contingencies. The Group companies received no significant environment-related grants in 2016 or 2015.

29. OTHER INFORMATION

KPMG is the main auditor of the annual accounts of the Group companies, except in the case of INELFE, which is audited by PricewaterhouseCoopers, and TEN, an equity-accounted investee audited by Deloitte.

The total fees accrued for the audit services rendered to the Group companies in 2016 were Euros 247 thousand (Euros 245 thousand in 2015). Fees were also accrued for other assurance services performed by KPMG in Group companies totalling Euros 46 thousand (Euros 63 thousand in 2015).

Furthermore, in 2016 other companies directly or indirectly related to the main auditor accrued fees of Euros 73 thousand for professional advisory services (Euros 66 thousand in 2015).



30. EARNINGS PER SHARE

Details of earnings per share in 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015 (*)</u>
Net profit (thousands of Euros)	636,920	606,013
Number of shares	541,080,000	541,080,000
Average number of own shares	1,945,242	1,334,955
Basic earnings per share (Euros)	1.18	1.12
Diluted earnings per share (Euros)	1.18	1.12

(*) In 2016 a share split was performed resulting in four new shares per each old share. For the purpose of comparing the Euros per share in both years, data on the Euros per share in 2015 are presented on a like-for-like basis in relation to the split performed in 2016 (see note 11).

At 31 December 2016 and 2015 the Group has not conducted any operations that would result in any difference between basic earnings per share and diluted earnings per share.

31. SHARE-BASED PAYMENTS

Details of share-based payments at 31 December 2016 and 2015 are as follows:

RED ELÉCTRICA GROUP
Share-based payments
at 31 December 2016 and 2015

	<u>2016</u>			<u>2015 (*)</u>		
	<u>Number of shares</u>	<u>Average price (Euros)</u>	<u>Amount in thousands of Euros</u>	<u>Number of shares</u>	<u>Average price (Euros)</u>	<u>Amount in thousands of Euros</u>
Management	1,368	17.54	24	1,824	19.72	36
Employees	129,360	17.54	2,268	85,140	19.72	1,679
	=====	=====	=====	=====	=====	=====
TOTAL	130,728	17.54	2,292	86,964	19.72	1,715

(*) In 2016 a share split was performed resulting in four new shares per each old share. For the purpose of comparing the Euros per share in both years, data on the Euros per share in 2015 are presented on a like-for-like basis in relation to the split performed in 2016.



These shares have been valued at the listed price on the delivery date. All shares delivered were approved by the Parent's shareholders at the general meeting, and the related costs incurred have been recognised under personnel expenses in the consolidated income statement.

32. 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 Captales. The Group thereby increased its ownership of this Peruvian company to 100%.

The effective date of this acquisition is 1 January 2017.



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

APPENDIX I

RED ELÉCTRICA GROUP
Details of equity investments at 31 December 2016 and 2015
(Expressed in thousands of Euros)

Company - Registered office - Principal activity	2016 Percentage ownership (1)		2015 Percentage ownership (1)	
	Direct	Indirect	Direct	Indirect
Red Eléctrica Corporación, S.A., Parent, incorporated in 1985. - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Management of the business Group; rendering of assistance or support services to investees and operation of the property owned by the Company.				
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%	-	100%	-
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%	-	100%	-
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%	-	100%	-
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%	-	100%	-
Red Eléctrica de España Finance, B.V. (RBV) - Hoogpoorddreef 15. Amsterdam (Netherlands). - Financing activities. - Incorporated in 2003 in the Netherlands to issue debt to finance the Red Eléctrica Group.	100%	-	100%	-
Red Eléctrica Financiaciones, S.A.U. (REF) - Paseo Conde de los Gaitanes, 177. Alcobendas. Madrid. (Spain). - Financing activities.	100%	-	100%	-
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%	-	100%	-
Red Eléctrica Andina, S.A. (REA) - Av. Alfonso Ugarte N° 536 Cercado. Arequipa (Peru). - Rendering of line and substation maintenance services.	-	100%(a)	-	100%(a)
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)	-	55%(a)
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)	-	55%(d)
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)	-	66.25%(c)
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)	-	-
Red Eléctrica Chile SpA (RECH) - Avenida El Golf n° 40, piso 20. Comuna de Las Condes, Santiago (Chile) - Acquisition, holding, management and administration of securities.	-	100%(a)	-	100%(a)
B) Proportionately consolidated companies				
Interconexión Eléctrica Francia-España, S.A.S. (INELFE) - Tour Initialle, 1 Terrasse Bellini – 92919 Paris La Défense Cedex. Paris (France). - Study and execution of Spain-France interconnections.	-	50%(b)	-	50%(b)
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)	-	-

(1) Equivalent to voting rights.

- (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



RED
ELÉCTRICA
CORPORACIÓN

RED ELÉCTRICA GROUP **Consolidated Directors'** **Report**

2016

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



Contents

1. COMPANY POSITION.....	3
1.1. ORGANISATIONAL STRUCTURE.....	3
1.2. ACTIVITIES AND BUSINESS PERFORMANCE	6
2. BUSINESS PERFORMANCE	11
2.1. KEY FINANCIAL INDICATORS.....	11
2.2. ENVIRONMENT AND PERSONNEL	12
2.2.1. ENVIRONMENT	12
2.2.2. PERSONNEL	13
3. LIQUIDITY AND CAPITAL.....	15
4. RISK MANAGEMENT	16
5. AVERAGE SUPPLIER PAYMENT PERIOD "“REPORTING REQUIREMENT", THIRD ADDITIONAL PROVISION OF LAW 15/2010 OF 5 JULY 2010.....	16
6. SIGNIFICANT EVENTS OCCURRING AFTER THE REPORTING PERIOD.....	16
7. OUTLOOK	17
8. RESEARCH, DEVELOPMENT AND INNOVATION (R&D&i).....	18
9. OWN SHARES	20
10. OTHER RELEVANT INFORMATION.....	20
10.1. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS.....	20
10.2. DIVIDEND POLICY.....	22
10.3. CREDIT RATING	22
10.4. EXCELLENCE AND CORPORATE RESPONSIBILITY	22
11. ANNUAL CORPORATE GOVERNANCE REPORT	23



1. COMPANY POSITION

1.1. ORGANISATIONAL STRUCTURE

Corporate bodies

The board of directors and the shareholders are responsible for governing and managing the Red Eléctrica Group and its Parent, Red Eléctrica Corporación, S.A. (hereinafter REC).

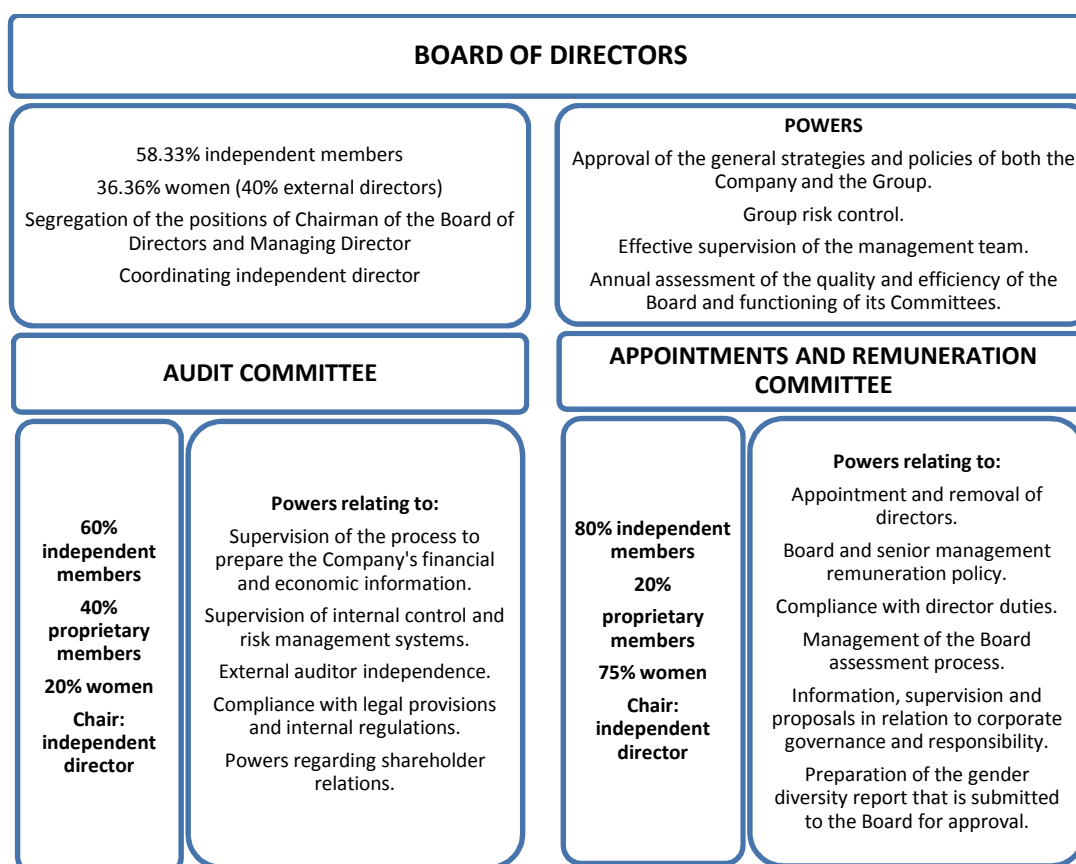
The shareholders' general meeting is governed by the articles of association and the general meeting regulations, in accordance with the Spanish Companies Act. The ownership structure at the date of the 2016 shareholders' ordinary general meeting was as follows:



The board of directors has formed two permanent committees: the Audit Committee and the Appointments and Remuneration Committee, which are regulated by the articles of association and the regulations of the board of directors, as well as by all applicable corporate governance legislation.

At 31 December 2016 the board of directors of Red Eléctrica Corporación, S.A. was made up of 11 members. At its meeting held on 29 November 2016, the board resolved to accept the resignation of Mr. Agustín Conde Bajén from the position of independent director of the company. At 31 December 2016, therefore, one independent director position on the board of directors and on the Appointments and Remuneration Committee was vacant.

The composition and powers of the board of directors and the various committees are as follows:



In view of the commitment undertaken by the company chairman at the general shareholders meeting held in April 2012, and considering international best practice in the field of corporate governance, at the extraordinary meeting held on 17 July 2015, called specifically for that purpose, the board of directors of Red Eléctrica submitted for the approval of the shareholders a proposal to segregate the positions of chairman of the board of directors and chief executive of the company, and to appoint Juan Lasala Bernad as executive director. The two motions were passed, with votes in favour from 99% of the shareholders, compared to the required quorum of 58%. At its meeting held on 28 July 2015, the board of directors appointed the new executive director as managing director of the company.

A transition period was established for the segregation of powers, which ended on the date of the shareholders' ordinary general meeting in 2016, resulting in full segregation of duties between the positions of chairman of the board and managing director. Since that meeting, the chairman of the board of directors has only had the responsibilities inherent in that position.

Until the shareholders' 2016 ordinary general meeting, the chairman continued to exercise executive powers, focusing his efforts on directing, supporting and overseeing the transfer of executive powers to the new managing director to enable an orderly and systematic transfer of those powers during the transition period.

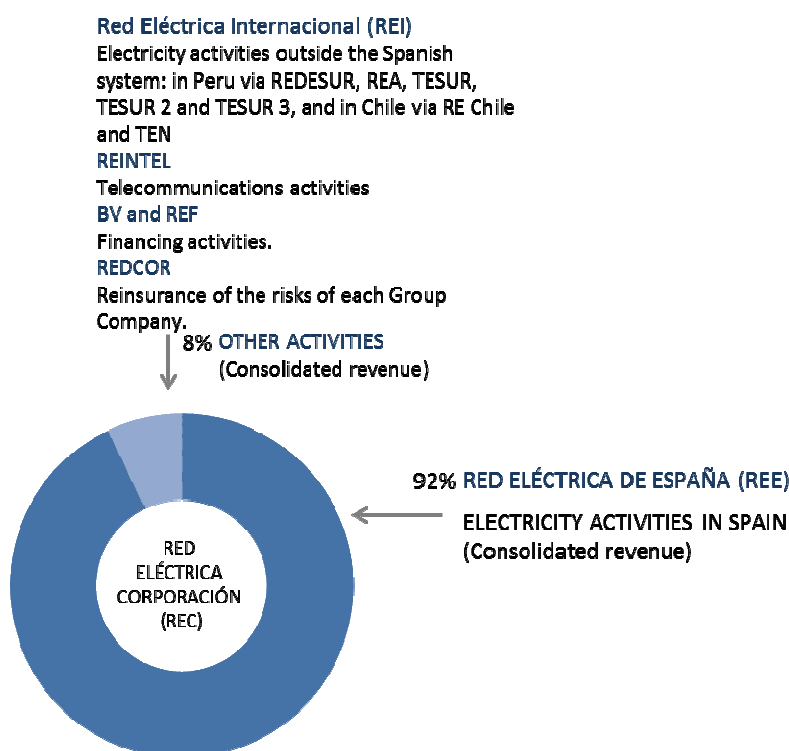


Moreover, the position of coordinating independent director created in 2013 has been maintained, since the shareholders and proxy advisors consider that this position embodies an efficient corporate governance practice through the responsibilities attributed to it.

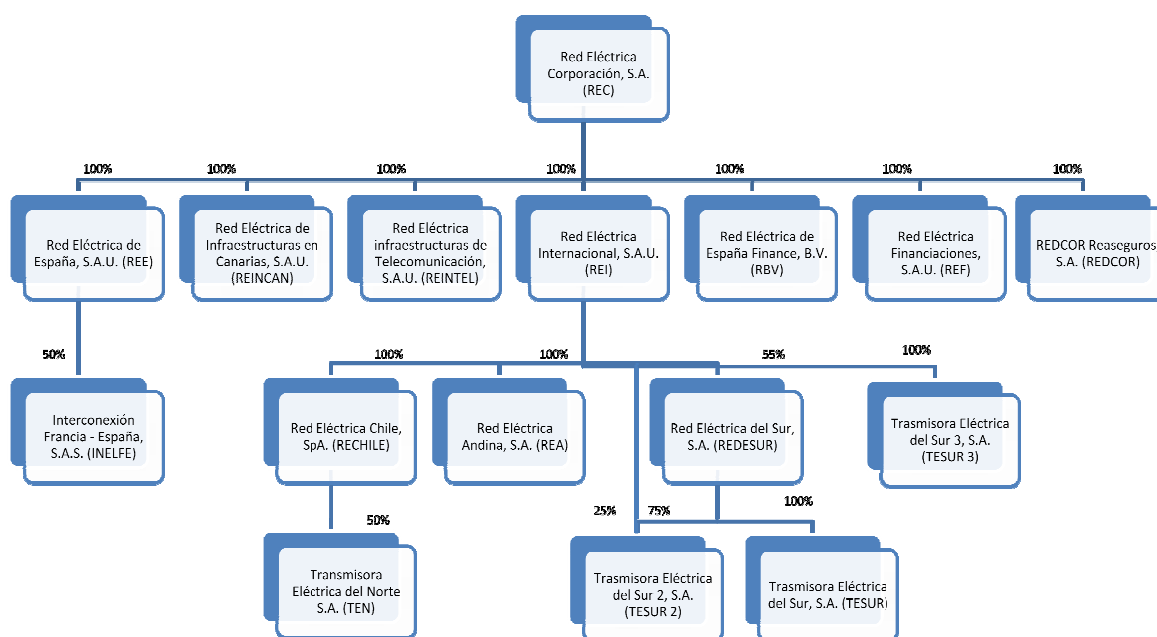
The Annual Corporate Governance Report, which is attached hereto, contains detailed information regarding the composition and operation of the governing bodies of the Parent.

Composition of the Red Eléctrica Group

The Red Eléctrica Group's principal activity is electricity transmission and system operation in Spain via Red Eléctrica de España S.A.U. (REE), which generates 92% of consolidated revenues and represents 92% of the Group's total assets (93% and 94%, respectively, in 2015). Other activities together account for the remaining 8% of revenues and 8% of total assets (7% and 6%, respectively, in 2015). The Group is present in six countries: Spain, Peru, Chile, the Netherlands, Luxembourg and France.



In 2016, there were changes in the consolidated Group, as described in note 2g to the consolidated annual accounts. At 31 December 2016, the composition of the Group was as follows (for more information on the activity of each company, see Appendix I to the notes to the consolidated annual accounts):



1.2. ACTIVITIES AND BUSINESS PERFORMANCE

The Group carries out the aforementioned activities in Spain and abroad, most notably electricity transmission in Spain, Peru and Chile, and rendering telecommunications services to third parties.

Role of transmission agent and system operator for the Spanish electricity system

The mission of Red Eléctrica de España, S.A.U. (hereinafter REE), as transmission agent and system operator for the Spanish electricity system, is that of ensuring that the Spanish electricity system functions correctly and guaranteeing the continuity and security of the electricity supply at all times. To this end, it oversees and coordinates the generation and transmission system and manages the development of the transmission network. The Company seeks to fulfil its mission while adhering to the principles of neutrality, transparency, independence and economic efficiency, so as to offer a secure, efficient and high quality electricity service to society as a whole.

The approval of the Plan for 2015-2020 has brought the certainty required to implement the Investment Plan.

2016 is the first year in which the remuneration for the transmission activity has been set pursuant to the new remuneration model approved in 2013.

Investments in the transmission network in 2016 totalled Euros 398.5 million and were basically to address technical restrictions, extend the network mesh, execute specific projects for international interconnections and inter-island underwater connections, and to ensure security of supply and network reliability.



During the year, 673.6 km of new lines and 61 new substation bays came into service, while transformation capacity was increased by 1,500 MVA, bringing the nationwide total up to 86,044 MVA.

The most significant initiatives in terms of development and renewal of the transmission network, by major works or axes, were as follows:

- Asturias-Galicia Link: the purpose of this axis is to ensure security and quality of supply throughout the northern axis, connecting the north of Galicia and the west of Asturias to address forecast consumption in the region and facilitate evacuation of new generation energy. A large portion of this axis entered into service before 2011. In 2016, the Boimente-Pesoz line came into service.
- Godelleta axis: aimed at resolving technical restrictions in Valencia. In 2016 further progress was made on construction and towards its entry into service.
- Torremendo axis: aimed at enhancing the reliability of the transmission network in Alicante. In 2016 further progress was made on construction and towards its entry into service.
- Sabinal axis: construction of the pertinent input and output points has increased the reliability of the electricity supply to Gran Canaria, reducing the concentration of electricity generation in the island's northern hub and relieving the Jinamar substation.
- Aragón-Levante line: this line connects the Aragón, Fuendetodos, Muniesa, Mezquita and Morella substations, enabling new generation wind power to be evacuated and reinforcing the transmission network. In 2016, the Mezquita-Morella line came into service.

Actions to reinforce international and inter-island interconnections included the following:

- Interconnections with France: in 2016 the preliminary works and studies for the planned new interconnections with France were ongoing. All of these facilities are expected to enter into service after 2020.
- Inter-island interconnections: these include the Mallorca-Ibiza interconnection aimed at resolving Ibiza's isolation in terms of electricity, as well as enabling system cost savings and encouraging competition in energy generation on the islands. This new link reinforces the electrical integration of the Balearic Islands and the Spanish mainland and is essential to guarantee a reliable supply of energy to the archipelago.

The electrical connection takes the form of a dual high-voltage alternating-current link with a power of 100 MVA per circuit, a voltage of 132 kV, and a total length of 126 km. The second line of this link came into service in February 2016.

- Other inter-island connection projects are at the preliminary stages: Mallorca-Menorca, Ibiza-Formentera and Lanzarote-Fuerteventura.

The most notable events in 2016 were as follows:



- Mainland energy demand closed the year at 249,923 GWh, up 0.6% on 2015. Corrected for the effect of working patterns and temperatures, demand attributable primarily to economic activity remained relatively level vis-à-vis 2015 and without growth, unlike in the previous year when growth of 1.7% was posted.
- Maximum instantaneous power was recorded on Tuesday 6 September at 13:32 hours, at a rate of 40,489 MW. This is down 0.6 % on the maximum for the prior year, and is 10.9% lower than the record of 45,450 MW posted on 17 December 2007. Peak demand in terms of time was also posted on 6 September (between 13:00 and 14:00 hours) at 40,144 MWh, 10.5% below the all-time high obtained in 2007.
- Installed capacity on the mainland has fallen compared to the prior year, ending 2016 at 100,088 MW, which is 916 MW (0.9%) less than at December 2015. The most notable variations were seen in coal-fired production, where power slid 932 MW as a result of the closure of the Compostilla 2, Elcogás, Narcea 1, Puertollano and Soto de la Ribera 2 plants. The capacity of other technologies either did not vary or changed only insignificantly.
- In 2016 the auctions for the rendering of the interruptibility service in 2017 were successfully conducted. Specifically, the country's electricity-intensive industry competed to be assigned the service in auctions that awarded 2,975 MW of interruptible resources for 2017.
- In 2016, renewable energy's percentage contribution to total energy generation in the electricity system climbed to 40.8% (36.9% in 2015). In absolute terms, renewable generation is up 7.8% on the prior year, essentially due to the 27.6% increase in hydroelectric generation.
- Electricity exchanges through the mainland-Balearic Islands link resulted in a net balance of exports to the islands of 1,251 GWh (6.4% less than in 2015), covering 21.4% of their demand.
- At the 2016 year end, total annual demand for electricity in non-mainland systems had increased by 1% on the prior year. By systems, demand rose by 0.7% in the Balearic Islands, 1.3% in the Canary Islands and 2.6% in Ceuta, but declined by 2.4% in Melilla.
- International electricity exchanges resulted in a net import balance for the first time since 2003, totalling 7,667 GWh in 2016. Exports amounted to 14,178 GWh (15,089 GWh in 2015) and imports totalled 21,845 GWh (14,956 GWh in 2015).

Canary Islands infrastructure

Red Eléctrica Infraestructuras en Canarias, S.A.U. (REINCAN) is the Red Eléctrica Group company that develops pumped-storage hydroelectric power plants in the Canary Islands. These are geared towards security of supply, system security and the integration of unmanageable renewable energies, pursuant to article 5 of Law 17/2013.

In 2015 the Soria-Chira 200 MW hydroelectric pumping power plant project in Gran Canaria was transferred to the system operator, as stipulated in Order IET/728/2014 of 28 April 2014. Once REE had assumed ownership of the project in 2016, and pursuant to Law 17/2013, for the purposes of implementing a new energy model in Gran Canaria to improve security of supply,



system security and the integration of renewable energies, a revised project was submitted in July 2016, which includes technical and environmental improvements.

The revised project was declared to be of strategic interest by the Regional Government of the Canary Islands in 2016 and has been submitted for consideration by the government. As such, it is estimated that construction may begin soon.

Telecommunications business

The Red Eléctrica Group's telecommunications business primarily operates in Spain, doing so through the subsidiary Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. (REINTEL).

REINTEL is the Red Eléctrica Group company responsible for operating telecommunications networks and rendering telecommunications services to third parties.

REINTEL is a neutral provider of telecommunications infrastructure. Its principal activity is leasing dark fibre and associated infrastructure. REINTEL has a fibre optic network in excess of 33,000 km rolled out over the electricity transmission grid and the railway network, guaranteeing transparent access on equal terms to its customers and to sector players.

No significant events were recorded in 2016 that could influence the performance of the business. REINTEL has been awarded, for a period of 20 years, the rights to use and operate the fibre optic network not used for railway services, and the related infrastructure, owned by Adif-Alta Velocidad. This transaction was executed on 20 November 2014.

International business

The Red Eléctrica Group has conducted its international business through its subsidiary Red Eléctrica Internacional, S.A.U. (REI), which holds equity investments in the Peruvian companies Red Eléctrica Andina, S.A.C. (REA), Transmisora Eléctrica del Sur, S.A. (TESUR), Transmisora Eléctrica del Sur 2, S.A. (TESUR 2), Transmisora Eléctrica del Sur 3, S.A. (TESUR 3), Red Eléctrica del Sur, S.A. (REDESUR), and also has companies in Chile, namely Red Eléctrica Chile, S.p.A. (RECH) and Transportadora Eléctrica del Norte, S.A. (TEN).

In 2016, the management excellence of REDESUR and TESUR (the companies that manage transmission infrastructure in Peru) and their commitment to stakeholder satisfaction allowed them to offer a transmission service with maximum availability, while supporting development in their operating environment.

For REDESUR, consolidation of the Integrated Management System (IMS) has allowed the company to continue delivering excellent operating standards, with a network availability factor of 99.86% in 2016, above the average for the last five years (99.8%).

TESUR, meanwhile, is currently at the initial stages of operating the concession for the 220 kV Tintaya-Socabaya transmission line, awarded in 2010 for a period of 30 years following its entry into commercial service in mid-2014. The availability factor for TESUR's network was 99.85% in 2016.



REA renders maintenance services for the REDESUR and TESUR facilities. Furthermore, in 2016 REA completed all of the tasks required to implement the special projects undertaken by REDESUR, as well as carrying out the pending actions relating to TESUR facilities and rendering management services for TESUR 2 and TESUR 3 construction projects.

REA also carries out facilities maintenance and supervises works for other clients, consolidating its position in southern Peru as a leading provider of such services.

The new TESUR 2 and TESUR 3 projects, awarded in 2015, are currently under construction and at different stages of development.

TESUR 2 has been awarded the concession for the 115 km, 220 kV Azángaro-Juliaca-Puno line, and associated substations, in Peru. This project involves the design, construction, operation and maintenance of the line for 30 years and the expected investment is USD 70 million. The project is currently at the construction stage, now that all the pertinent administrative permits have been obtained.

TESUR 3 has been awarded the concession for the 129 km, 220 kV Montalvo-Los Héroes line, and associated substations, also in southern Peru. This project involves the design, construction, operation and maintenance of the line for 30 years and the expected investment is approximately USD 40 million. The project was awarded in December 2015 and is at the initial stages of the construction phase, the concession agreement having been signed in September 2016.

RECH was acquired by REI in November 2015. Its principal activity is the acquisition, holding, administration and management of any equity investments the Group may hold in Chile. REI holds 100% of this company's share capital, which amounts to US Dollars 110 million. In turn, RECH holds a 50% equity investment in Transmisora Eléctrica del Norte (TEN), while the other 50% is held by the Chilean company Engie Energía Chile, a subsidiary of the ENGIE Group.

Both of these companies are involved in the construction and commercial operation of the Mejillones-Cardones transmission line in Chile, which is being developed by TEN. The project forms part of Chile's backbone transmission system, comprising a 500kV line spanning a distance of 600 km, connecting the Central Interconnected System (SIC) and the Far North Interconnected System (SING).

At the 2016 year end, construction of these facilities was at an advanced stage, with a percentage of completion of 75%. In view of the timely progress being made on these works, commercial operation of the facilities is expected to commence in the last quarter of 2017, as scheduled.

In December 2016 the TEN financing agreements were finalised with nine local and international banks, for a total amount of US Dollars 856 million and with maturity dates in 2034 and 2042. This financing has received various accolades in financial circles:

- The Project Finance International (PFI) Awards selected TEN as LatAm Power Deal of the Year.
- IJGlobal Awards-Euromoney 2016 named the TEN financing Latin American Transmission Deal of the Year.

This acquisition has enabled the Red Eléctrica Group to start operating in Chile and consolidate its position in the border regions of northern Chile and southern Peru.



2. BUSINESS PERFORMANCE

2.1. KEY FINANCIAL INDICATORS

Revenue for 2016 amounted to Euros 1,932.3 million, down 0.3% on the prior year. This figure includes the remuneration for the transmission activity in Spain, which encompasses the facilities that came into service in 2015. It also comprises revenue of Euros 86 million from telecommunications services rendered, regulated revenue of Euros 56 million for system operation, and revenue from transmission activity conducted abroad, amounting to Euros 19.8 million.

EBITDA¹ amounted to Euros 1,486.0 million, climbing 1.9% year-on-year.

With regard to operating expenses:

- The **cost of supplies and other operating expenses** fell 3.0% in 2016, a continued reflection of the Red Eléctrica Group's efforts throughout the year to achieve efficiency. Not taking into account the effect of including the implementation costs of new investment projects in Peru, pursuant to IFRIC 12 (expenses with a balancing entry for a similar amount in Group revenue), the cost of supplies and other operating expenses would have dropped by around 6% for the year as a whole.
- **Personnel expenses** were 3.9% higher than in the prior year. Slightly more than half the increase is due to the trend in salaries and wages, reflecting the larger workforce. The remainder is a result of the rise in employee benefits and similar expenses.

The **headcount** was 1,773 at 31 December 2016, while the average workforce was 1,765 employees, up 0.6% on 2015.

EBIT² totalled Euros 1,003.3 million, up 1.4% year-on-year. The increase in this item is offset by the 3.0% rise in the depreciation and amortisation charge for non-current assets, in connection with facilities that came into service during the year.

The **net finance cost** amounted to Euros 151.3 million, compared with a net finance cost of Euros 159.3 million reported in the prior year. This improvement is essentially due a drop in interest as a result of lower borrowing costs.

Profit for the year totalled Euros 636.9 million, up 5.1% on the previous year. The effective tax rate was 24.9%, which is 2% lower than in the prior year, in view of the corporate income tax rate being reduced in Spain.

The Group's **investments** in 2016 amounted to Euros 643.1 million, a year-on-year rise of 43.6%. This amount includes the Euros 398.5 million earmarked for the transmission network in Spain, and Euros 199.8 million reflects the 50% equity investment in the Chilean company TEN. TEN invested a total of Euros 273 million in Chile throughout 2016.

Dividends paid with a charge to profit for the year amounted to Euros 432.8 million, equal to 0.8025 Euros per share. This is an increase of 7% on the amount paid out in 2015, as considered in the Strategic Plan for 2014-2020.

At the end of 2016, 96% of the Group's financial debt is non-current. In terms of interest, 84% is fixed-rate and the remaining 16% is variable-rate.

¹ EBITDA is calculated as the sum of revenue, self-constructed assets and other operating income less personnel expenses, supplies and other operating expenses.

² EBIT is calculated as EBITDA plus any non-financial capital grants recognised and gains/losses or impairment on asset disposals, less depreciation and amortisation.



In 2016, the average cost of the Group's financial debt was 2.94%, compared to 3.20% in the prior year. Average gross debt was Euros 5,462.1 million, compared with Euros 5,418.9 million in the previous year.

Finally, Red Eléctrica Group's **equity** amounted to Euros 2,920.5 million, rising 5.8% vis-à-vis the figure posted at the 2015 year end. This growth is primarily due to profit for the period.

Financial indicators (millions of Euros)	2015	2016	Δ%
Revenue	1,938.9	1,932.3	-0.3%
EBITDA	1,458.4	1,486.0	1.9%
EBIT	989.0	1,003.3	1.4%
Net profit	606.0	636.9	5.1%
ROE (post-tax profit/Equity)	22.0%	21.8%	-0.9%
Cash flows from operating activities	1,326.1	1,007.1	-24.1%
Distribution of dividends	404.8	432.8	7.0%
Equity	2,760.6	2,920.5	5.8%
Gearing	64.0%	62.9%	-1.7%
Investments	447.8	643.1	43.6%
Total assets	10,597.9	10,550.4	-0.4%
Debt service coverage ratio (Net debt/EBITDA)	3.36	3.33	-0.8%

2.2. ENVIRONMENT AND PERSONNEL

2.2.1. ENVIRONMENT

The Group carries out its activities in accordance with strict environmental criteria incorporated into and enforced through the Group's environmental policy.

The commitment to the environment originates from Group management, which defines the environmental policy (reviewed and approved in October 2014) and implements measures to comply with environmental requirements by means of an Environmental Management System that is certified under ISO 14001 and EMAS regulations.

The involvement of all of the organisational units and the commitment of all of the Group's employees are essential to the implementation of this system. A specific environmental department therefore exists to provide technical support.

The main environmental challenges facing the Group are as follows:

- Ensuring that facilities are compatible with the environment, selecting layouts and locations to minimise environmental impact. Application of preventative and corrective measures and strict environmental criteria in all stages of activity means that the potential impact on the environment is immaterial.
- Ensuring the protection and conservation of biodiversity, to which end the Group has implemented a specific strategy covering the following areas of action: protection of fauna (particularly birdlife) and flora, fire prevention and development of conservation projects.



- Contributing to the fight against climate change, which has led the Group to define its Climate Change Strategy (reviewed and approved in May 2014). Various measures were implemented in 2016 aimed at energy savings and energy efficiency, primarily in relation to sustainable transport and reducing electricity consumption.

Ordinary expenses incurred by the Group in 2016 in relation to the protection and improvement of the environment amounted to Euros 19,804 thousand. In addition, investment in environmental actions totalled Euros 4,469 thousand in 2016.

2.2.2. PERSONNEL

The roll-out of the Human Resources master plan, which commenced in 2014, continued in 2016. This plan is linked to the Group's Strategic Plan and defines initiatives and projects that promote its implementation at all levels of the Group.

To facilitate achievement of business objectives, against a backdrop of commitment and a favourable social climate, the master plan is based on four pillars: strategic business partners, management excellence, talent management and leadership in health and safety.

The effectiveness of the plan is monitored through human resources scorecards and regular climate and satisfaction surveys. The plan is reviewed and updated annually to include proposed improvements and suggestions.

Stable, high quality employment

In 2016, following the organisational adjustments deriving from the segregation of duties between the chairman of the board of directors and the managing director, the organisational structure was remodelled so as to address the challenges of the Strategic Plan.

At the end of 2016, the Group's workforce comprised 1,773 professionals. The commitment to employment stability is reflected in the high percentage (almost 100%) of employees on permanent contracts and the fostering of internal promotions.

Variations in the average and year-end headcount in 2015 and 2016 were as follows:

	2015	2016	Δ%
Average headcount	1,755	1,765	0.6%
% men	77.9%	76.6%	-1.7%
% women	22.1%	23.4%	5.9%
Year-end headcount	1,763	1,773	0.6%

Diversity and integration

The Group promotes equal opportunities in all aspects of its people management, and implements programmes, internal procedures and initiatives to foster diversity and integration, addressing factors such as age, gender and disability.



Throughout 2016, initiatives aimed at increasing the representation of women in positions traditionally occupied by men were ongoing. At 31 December, 20% of managerial positions were held by women.

In 2016 implementation of the action plan to integrate disabled employees began. The Group benefits from the collaboration of the Fundación Adecco in this respect, as well as the full involvement of the Group's management team. At the 2016 year end, the Group's workforce included 13 disabled employees (10 men and 3 women).

The action plan associated with the Workforce Ageing Management Plan, approved in 2015, also got underway during the year.

Talent management

Roll-out of the Talent Management Model throughout 2016 has boosted learning and professional development amongst the Group's people in different aspects:

- A development programme has been devised as part of the Leadership Model, aimed at qualified technical personnel who coordinate the work of the functional teams.
- Red Eléctrica's Knowledge Management Model action plan has got underway and the governing body that will facilitate its implementation has been created.
- The Bank of Potential programmes for technical personnel and department heads are still ongoing. These are the main sources when recruiting for managerial positions.

In 2016 work was undertaken to define the Corporate University, Red Eléctrica Campus. With its innovative methods, modern infrastructure and advanced technology, this will serve as the channel to roll out the strategy, values and culture of the Group.

All employees are assessed annually in terms of skills, commitment and contribution. In 2016, for the first time, the digital skills-related performance of all employees has been appraised.

Dialogue and transparency

The new miRED intranet was the main addition to internal channels, focusing on shared communication between all of the organisation's units and collaborative spaces to connect people and promote dialogue.

The action plans arising out of the climate survey conducted in 2015, which provided detailed feedback on key issues relating to human resources management, got underway in 2016.

At the tail-end of 2016, the Group launched its internal communications assessment survey to gauge the opinion of its employees across the board and hear their thoughts on management, initiatives and channels, so as to identify areas requiring improvement and meet workforce communication needs.

Health and safety

In 2016 a rules and regulations document was approved, which contains the main components of the management system, principles and general guidelines, details of those in charge of the model, the related regulations regarding company welfare management, and a communications plan for the Healthy Company Model. A manual providing specific information on all aspects of the Model was also published.



To raise awareness amongst employees with regard to occupational risk prevention, in 2016 the Group provided 5,850 hours of health and safety training to 1,165 members of its personnel. Specific training on electricity-related risk made up 410 of these hours.

Work-life balance

Developments in recent years in the work-life balance model have enabled REE to enhance its HR management strategy. The challenge lies in being able to assess, on a case-by-case basis, the dual demands placed on people (work-personal life) in order to manage the work-life balance more flexibly, based on a mutual commitment between the company and its people, with a view to enhancing wellbeing and quality of life.

3. LIQUIDITY AND CAPITAL

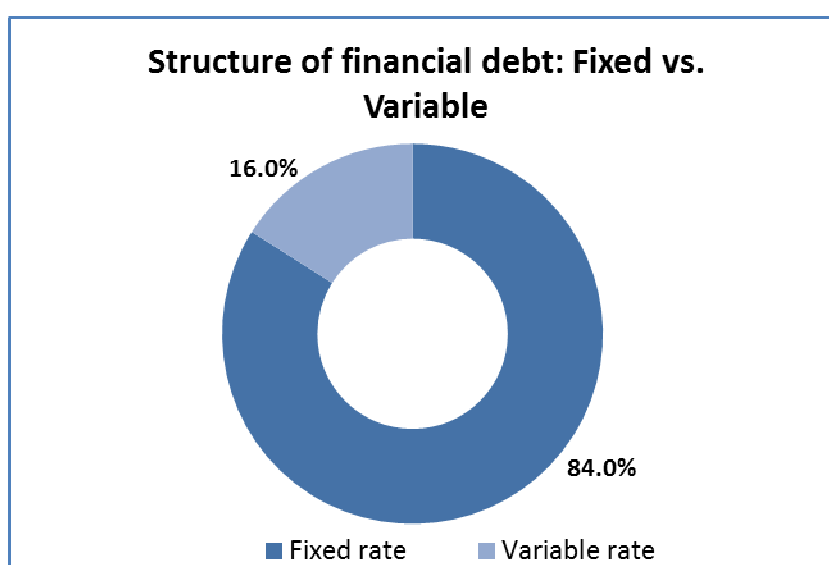
The Red Eléctrica Group's liquidity policy has been designed to ensure payment obligations are met, by diversifying how financing requirements are covered and when debt matures.

The Group's liquidity position is essentially based on robust cash flow generation, primarily through regulated activities. Coupled with appropriate management of collection and payment periods and current financial capacity through short- and long-term credit facilities, this allows the Group to prudently manage its liquidity risk.

The undrawn balance on credit facilities at 31 December 2016 amounts to Euros 2,002.5 million.

The average maturity of the debt drawn down at the end of the year is 5.7 years.

The Group's financial strategy has aimed to reflect the nature of its businesses, at all times adhering to legislation in force. The activities conducted by the Group are very capital-intensive, wherein investments mature over long periods. In addition, these assets are remunerated over long periods of time, meaning that financial debt is primarily long-term and fixed-rate.





The Group's capital structure policy ensures a financial structure that optimises the cost of capital through a sound financial position, which balances the generation of value for shareholders with competitive costs of financing. Capital is periodically monitored through the gearing ratio, which in 2016 stood at 62.9%, compared to 64% in 2015. This ratio is calculated as net financial debt divided by equity plus net financial debt.

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

4. 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.

Amongst the main risks identified as regards the Group achieving its objectives are regulatory risk, inasmuch as the Group's principal business lines are subject to regulations, operational risk, primarily relating to electricity system servicing activities, financial risk and environmental risk.

The risk management policies are detailed in note 15 to the accompanying consolidated annual accounts.

5. 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 in the case of Spanish Group companies was 46.2 days at the 2016 year end.

The disclosures required by this resolution are contained in note 19 to the Group's consolidated annual accounts for 2016.

6. SIGNIFICANT EVENTS OCCURRING AFTER THE REPORTING PERIOD

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

The effective date of this acquisition is 1 January 2017.



7. OUTLOOK

The Group 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.

The Group 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.

Outlook for regulated activities in Spain

Regulated activities primarily observe the following lines of action:

- Market integration and the sustainability of the electricity system, which justify maintaining the level of investment in the transmission network in coming years, in accordance with the new remuneration framework. The investment plan will focus on bolstering the process of reinforcing the structure and mesh of the grid and developing interconnections, especially in non-mainland systems.
- A goal of efficiency, enabling the Group to maintain its position as an international benchmark. Accordingly, the Company has reviewed its main operating processes, promoting a streamlined and flexible organisation that optimises the Company's returns and the efficiency of the mainland and non-mainland electricity systems.
- Implementation of new regulated activities, such as storage of energy in the island systems as a tool to guarantee the security of the non-mainland and isolated electricity systems.

The Group will apply a financial policy adapted to the new remuneration model for the transmission activity, ensuring that financial debt is diversified and its liquidity position can comfortably cover upcoming maturities, aiming for the most flexible financial structure possible.

Outlook for telecommunication activities

The telecommunications activities carried out by REINTEL, as telecommunications infrastructure supplier, will focus on the backbone fibre network market, specifically the lease of dark fibre optic infrastructure associated with agents in the telecommunications sector. To this end, REINTEL will continue to implement its commercial plan and undertake the investments requested by customers, in order to generate greater revenues.

Furthermore, REINTEL will continue to make progress on interconnecting rail and electrical fibre networks with the aim of offering new solutions to its customers, such as new redundant sources



and access points, whilst continuing to uphold the high standard of service quality offered to its customers.

Outlook for the international business

The Group will continue to focus its international business activity on strengthening its performance in countries where it has a presence, specifically Peru and Chile.

Moreover, as a way of expanding the business base, efforts will centre on executing projects or acquisitions that meet a number of geographical, strategic and financial criteria, so as to increase international presence.

Outlook for the infrastructure construction activity in the Canary Islands

REINCAN'S activity – the construction of energy storage facilities in the Canary Islands – will serve as a system operation tool, enabling greater integration of renewable energies while also enhancing security of supply in the non-mainland systems.

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

In 2016 a new Innovation Strategy was approved to leverage innovation as a driver for growth, cultural change and sustainability within the Red Eléctrica Group. This initiative aims to bring innovation to all corners of the business activity, focusing primarily on four key angles: digitalisation, people, sustainability and technology.

In the international arena, innovation activity undertaken as part of ENTSO-E projects is particularly noteworthy. ENTSO-E published the “R&D Monitoring Report 2015” during the year, evaluating the stage of completion of its I+D+i plan based on an analysis of the results of more than 70 innovation projects in which European TSOs played a major role. The updated “R&D Roadmap 2017-2026” was also published.

The collaboration with the European Technology & Innovation Platform (ETIP) for electricity networks is ongoing as part of the EU's SET Plan. Through REE, the Group sits on the steering committee as a representative of the European TSOs.

The MIGRATE project got underway in 2016 under the European Union's Horizon 2020 programme, in which REE is involved as a work package leader. The aim of this project is to heighten understanding of the performance of electricity systems operated with high penetrations of power electronics (generators, loads, HVDC links, FACTS, etc.). The BEST PATHS project (BEyond the State-of-the-art Technologies for re-Powering Ac corridors & multi-Terminal HVDC Systems) is also ongoing. This project is coordinated by REE and has 39 participating partners, including universities, technological centres, industry, electricity companies and European TSOs.

As regards projects implemented under domestic innovation programmes, work continues on AMCOS-Stability FACTS to design a prototype to improve the stability of frequency and voltage in small isolated systems.

Throughout 2016 work was ongoing on proprietary I+D+i projects such as ALMACENA, whereby an electrochemical storage system set up in Carmona (Seville) has enabled a more in-depth study of future applications of this new technology for the integration of renewable energies and improvements to system operation services. A comparative analysis has also been conducted vis-à-vis other electrochemical storage systems as part of a project with EPRI (Electric Power



Research Institute, United States) to enhance the experience acquired through the ALMACENA project, in terms of its integration into the electricity system, and as regards operation and maintenance. Furthermore, in 2016 the research conducted to support the PERFILA project drew to a close. This research used information from a panel of consumers equipped with smart meters, so as to improve the consumer profiles applied to customers whose consumption is not measured on an hourly basis.

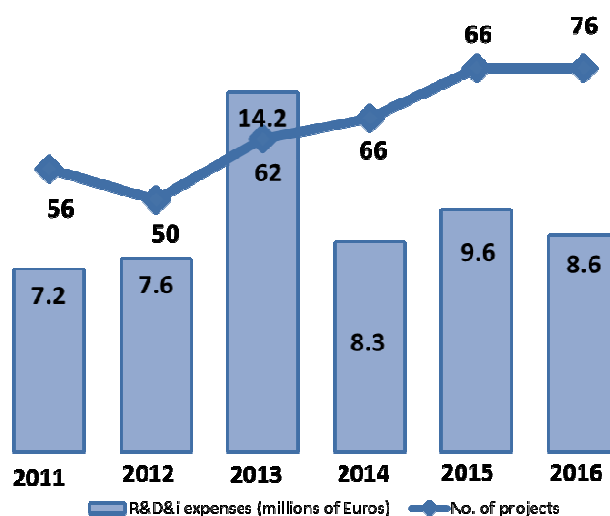
A number of projects were completed in 2016, notably the monitoring of underground lines using distributed temperature sensors (DTS), the inspection of electricity lines via feedback from photogrammetric methods based on images obtained using aerial photography, a phasor-based monitoring and control system installed on the islands of Lanzarote and Fuerteventura, a study of overvoltage arising due to ferroresonance on high-voltage networks, the use of drones to gather geographical information and inspect electricity lines, a methodology to enable optimum management of the entire treatment cycle for vegetation in the line channel, an optical current sensor to identify shortfalls in the underground section of mixed lines, a new predictor of mainland and non-mainland demand, automation of the delineation of as-built substation plans, a methodology to assess the condition of foundation support structures, and a prototype to enable real-time monitoring of electric vehicle charge points in Palma de Mallorca.

Projects geared towards environmental conservation include the development and validation of a ground-breaking technique, the first in the world, to recover underwater meadows formed by *Posidonia oceanica* – a highly-protected aquatic plant native to the Mediterranean – using laboratory-germinated seeds and bundles originating from natural fragmentation. This will mitigate the impact of laying undersea electricity cables in the Balearic Islands. In view of the positive results obtained from this project, Red Eléctrica will be planting *Posidonia oceanica* meadows as part of its “REE Forest” programme.

Development of a sustainable and flexible modular transformer has also successfully drawn to a close, the most notable feature of this system being that it uses environmentally-friendly vegetable oil. Moreover, a methodology that enables the oil collection pits of high-voltage machines to be emptied, as well as in situ catalyst-based treatment to separate the oils and fats from the water, has also been devised.

The Electric Power Research Institute (EPRI) in the United States, an organisation that engages in research for the electricity sector and in which a number of companies worldwide are involved, has announced REE as the recipient of one of its 2016 PDU Transfer Technology Awards for its collaboration in the analyses of integration and the impact of energy storage on electricity systems and, more specifically, for its development of a model to maximise the integration of renewable energies into its non-mainland systems.

Overall, the Group worked on 76 innovation projects in 2016, at a total cost of Euros 8.6 million.



9. 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 11 to the consolidated 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.

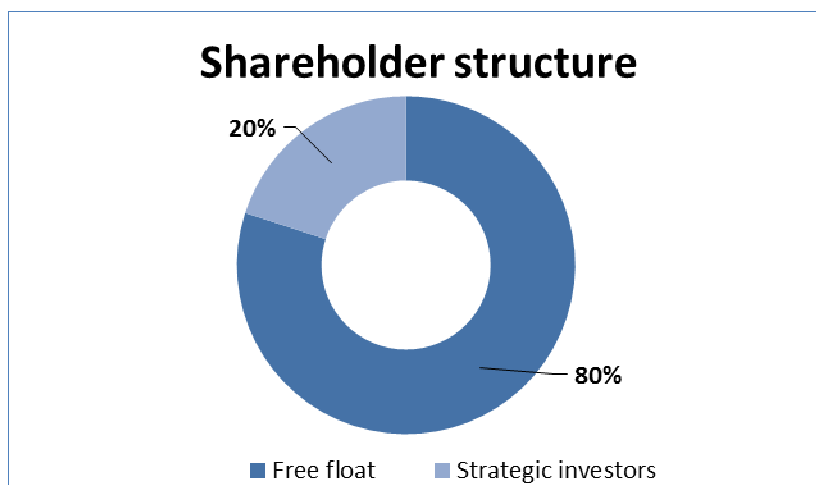
10. OTHER RELEVANT INFORMATION

10.1. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS

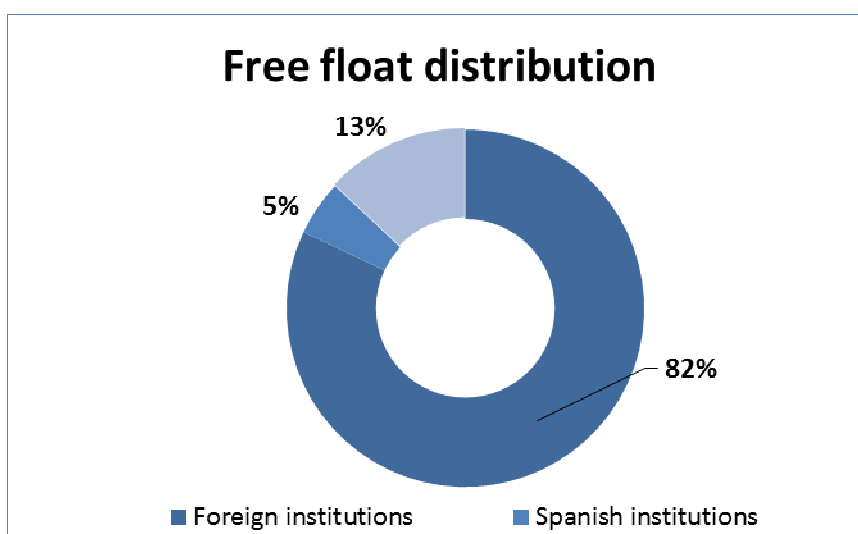
All of the shares in REC, the Group's listed company, are quoted on the four Spanish stock exchanges and are traded through the Spanish automated quotation system. REC also forms part of the IBEX 35 index, of which it represented 2.0% at the end of 2016.

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.

10.2. 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.

10.3. CREDIT RATING

On 3 August 2016 the rating agency Standard & Poor's issued a new report on Red Eléctrica maintaining its rating and outlook. Following this announcement, the Company and its subsidiary, Red Eléctrica de España, S.A.U., maintain long-term ratings of 'A-' and short-term ratings of 'A-2' with a stable outlook.

On 27 May 2016 the rating agency Fitch Ratings upgraded the Company's long-term rating to 'A' from 'A-' with a stable outlook. Following this announcement, Red Eléctrica Corporación, S.A. and Red Eléctrica de España, S.A.U. maintain long-term ratings of 'A' and short-term ratings of 'F1', with a stable outlook.

10.4. 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.

11. 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 consolidated 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 Group considers the expectations reflected in those statements to be reasonable, investors and holders of shares in the Parent 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 Group'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 Group 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 Group 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.