



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

06

APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

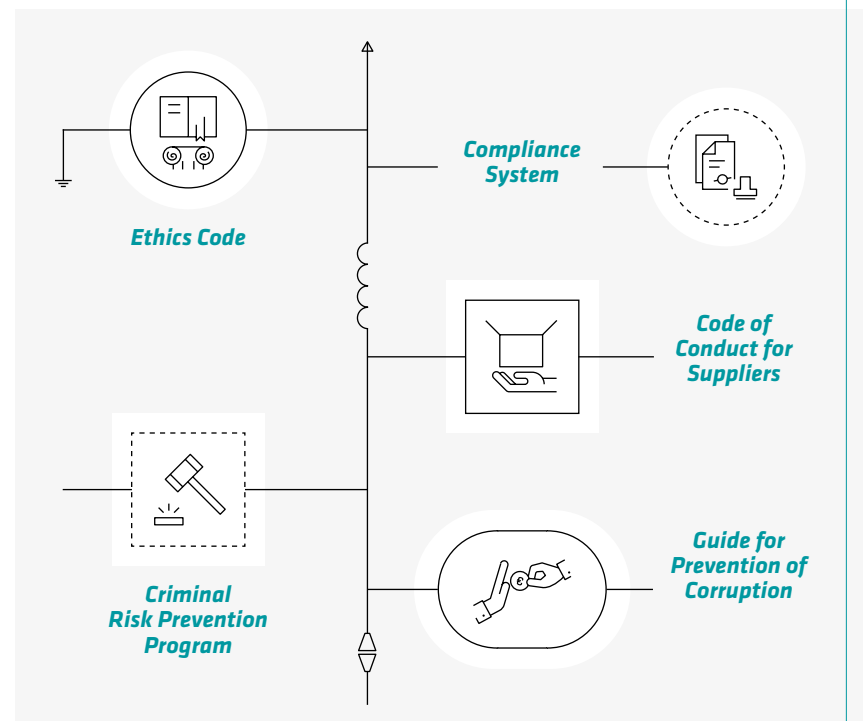
6.1 Ethics

For the Red Eléctrica Group, ethics and compliance are fundamental pillars of the proper pursuit of its business. This means acting with the utmost integrity in the performance of the Company's obligations and commitments, as well as in the relations and engagement with its stakeholders.

The Red Eléctrica Group has a number of rules of corporate conduct that lay down the values and standards of behaviour that must be embraced by all persons in the Red Eléctrica Group in the performance of their professional activities.

Red Eléctrica has a Compliance System aligned with best practices in this field, so as to ensure that the organization properly respects the obligations established and undertakings given and so develops a culture in which compliance risks are managed proactively.

INTEGRITY MODEL OF THE RED ELÉCTRICA GROUP





INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

6.1.1 ETHICS AND COMPLIANCE CULTURE

Awareness and training are key factors in developing a culture of compliance within the organization. Participation in the awareness-building actions and compliance training is mandatory for all members of the Red Eléctrica Group. The content of these actions is adapted to the needs and responsibilities of the functional areas and other affected areas of the Group.

The Compliance Unit is responsible for creating an enterprise-wide awareness and understanding of the importance and strategic role of the Red Eléctrica Group's compliance system within the organization's integrity culture.

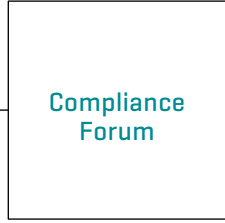
The actions included in the plan for building awareness and disseminating the Compliance System that was carried out in 2016-2017 and will be continued in the coming years included the startup of a programme of classes on the compliance

system attended in person by the members of the organization, with the participation of compliance expert advisors.

In addition, a Compliance Forum has been set up with representatives from different areas of the organization responsible for liaising with the Compliance Unit. The forum serves as a means of communication and general exchange of information on the compliance function, and on the novelties and best practices seen at the national and international level in that field.

As part of its commitment to regulatory compliance, Red Eléctrica has joined the Spanish Compliance Association [Asociación Española de Cumplimiento — ASCOM]. ASCOM was formed in 2014 as the first association with the objective of professionalizing the Compliance function, offering all its professional member and entities a platform to exchange ideas and best practices.

In-person training in the compliance system and function, as well as in the methodology for assessing compliance risks, targeted at specific groups within the organization



Composed of the main units, representatives and key positions in the compliance function, serving as means of communication and general exchange of information, and sharing of new developments and practical improvements seen at national and international level in compliance matters



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

6.1.2 ETHICS CODE

The purpose of the Red Eléctrica Group's Ethics Code is to provide an ethics guide for the management, directors and employees of the Red Eléctrica Group, laying down the values and commitments that should govern their activity in the Group.

The current version of the Red Eléctrica Group's Ethics Code was approved by the Board of Directors on 28 May 2013, responding to the demands of stakeholders and the recommendations of the bodies that set standards in this field, notably including the United Nations Organization, the European Union, the Organization for Economic Cooperation and Development and international bodies such as Transparency International and Fundación Étnor, amongst others.

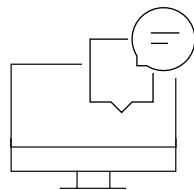
6.1.3 ETHICS CHANNEL

To encourage application of the Ethics Code, the Red Eléctrica Group has established an ethics channel on its corporate website, where users can submit inquiries, report wrongdoing and make suggestions to the Ethics Officer. The channel is

audited periodically and ensures the confidentiality of its users.

Red Eléctrica also has another channel for receiving reports of non-compliance, complaints, inquiries and ethical suggestions, the DÍGAME telephone hotline, which is available to external stakeholders who are not aware of the Ethics Channel.

COMMUNICATIONS CHANNELS WITH ETHICS OFFICER



ETHICS CHANNEL

DÍGAME



This service refers inquiries to the Ethics Officer, preserving confidentiality.

During 2017 the Ethics Officer was consulted 26 times via the Ethics Channel, with a maximum resolution time of 10 days. The consultations referred to the following standards of behaviour:

- Integrity, responsibility and transparency,
- Respect, dignity and non-discrimination,
- Responsible monitoring of management of suppliers,
- Limits on acceptance of gifts, loans and invitations.
- Proper safeguarding of information systems.

In 2017 seven breaches of the Ethics Code were received, five of which were resolved during the year and two are in the process of being resolved. More detailed information on those reports of breaches can be seen at the Company's website via the following link:

[Annual executive report on management of the Ethics Code](#)

Ethics Officer

To ensure awareness, application of and compliance with the Ethics Code, Red Eléctrica appointed Rafael García de Diego, general secretary and secretary of the Board of Directors, as Ethics Officer and stakeholder ombudsman. The responsibilities of the Ethics Officer are as follows:

- Respond to inquiries and advise all stakeholders on any doubts regarding the values and commitments set forth in the Ethics Code.
- Investigate complaints by examining and investigating the conduct of the employees or organizational units concerned.
- Prepare action plans to resolve complaints and submit them to the chairman of the Red Eléctrica Group for approval, or to the chairman of the Audit Committee if the complaint concerns a member of the Executive Committee.





INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

- Keep an up-to-date record of activity (inquiries, complaints, action taken and notifications to interested parties).
- Keep claimants informed of the status and resolution of their inquiry or complaint, when so requested.
- Prepare a periodic report reviewing the system and proposing improvements to the complaints management system.
- At all times keep the identity of the complainant confidential, unless disclosure is required by law.
- Perform the functions of the post with independence, rigour and equanimity.

6.1.4 TAX STRATEGY

The responsibility for setting tax strategy, formulating policy on tax risk management and control, and approving investments or transactions which due to their amount or special characteristics are considered strategic or which entail particular tax risk is reserved to the Board of Directors and

The Red Eléctrica Group is committed to complying with tax legislation and with its tax obligations, fosters a cooperative relationship with the tax authorities and considers the tax contribution in all territories where it operates as significant for the overall economic and social development.

cannot be delegated. This reflects the strategic role of Boards of Directors in tax matters.

The **Tax Strategy** of the Red Eléctrica Group was approved by the Board of Directors on 30 June 2015 and has as its purpose to define the approach to be taken to tax matters on a consistent basis and aligned with the strategy of the Group. It lays out the vision and objectives in the tax area, and is based on the three core values of transparency, good governance and responsibility.

The tax strategy's vision can be summed up as follows:

“Manage tax matters proactively, acting responsibly and transparently towards all stakeholders and in such a way as to comply with tax legislation and minimize reputational

risk, making compliance compatible with protection of shareholder value.”

The scope of application of the Tax Strategy includes all Red Eléctrica Group companies and covers the following tax obligations:

- Fulfilment of the obligation to file returns for and pay for taxes charged and borne.
- Fulfilment of the obligation to file returns for and pay taxes collected and paid for the account of third parties.
- Fulfilment of tax reporting obligations.

On 29 September 2015 the Board of Directors approved the Red Eléctrica Group's **Tax Risk Control and Management Policy** and its

integration into the Integrated Risk Management Policy. The tax risk management and control systems are described in Section 6.3 of this Report.

As part of the development of good practices that reduce tax risks, the following actions have been taken:

- Reporting on the tax policies applied in the annual corporate income tax return for 2016. This was done before the annual tax filing, at the Audit Committee meeting held on 21 June 2017.
- Reporting on the tax policies applied in the closing of accounts for financial year 2017. This was done in the Audit Committee meeting on 24 January 2018, before the financial statements for 2017 were authorized for issue.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

The Red Eléctrica Group has an enterprise-wide Risk Management System that includes the main tax risks for the Group and the mechanisms for their mitigation, control and management.

In addition, the Group has a System for Internal Control over Financial Reporting (ICFR) that includes tax reporting and processes and their associated controls, based on the COSO (Committee of Sponsoring Organizations of the Treadway Commission) methodology. These processes and systems undergo systematic internal and external audits.

The Red Eléctrica Group has diverse mechanisms to prevent unlawful operations, money laundering and asset stripping. These include the Ethics Code, the Code of conduct for suppliers, the Programme for the Prevention of Criminal Liability and the “Guide for the Prevention of Corruption: Zero Tolerance”, which is made available to Red Eléctrica Group employees, suppliers and stakeholders on the corporate website. The Red Eléctrica Group

also carries out awareness-building actions and ongoing training in which those documents are given to employees.

The Red Eléctrica Group’s Ethics Code and Tax Strategy establish a commitment not to create companies in order to evade tax in countries considered tax havens.

The Red Eléctrica Group has no presence or any operations in territories officially classified as tax havens [2] according to the current regulations.

Furthermore, at its meeting on 29 September 2015, the Board of Directors of Red Eléctrica Corporación, S.A. approved a resolution requiring the Red Eléctrica Group to subscribe to the **Code of Best Tax Practices** adopted by the Spanish Tax Agency (AEAT) within the framework of the Large Businesses Forum (Foro de Grandes Empresas). Adherence to those practices is in line with the tax principles and guidelines set out in the Group’s Tax Strategy.

On 28 October 2016, the Large Businesses Forum approved a proposal to strengthen good practices in business tax transparency, and proposed that companies issue an **“Annual Report on Tax Transparency for Companies Adhering to the Code of Good Tax Practices”**. Pursuant to the above, in 2017 the Red Eléctrica Group voluntarily submitted that tax transparency report to the Spanish tax administration in respect of fiscal 2016.

Following the practice started in 2014, and with the aim of voluntarily offering greater **tax reporting transparency** to its different stakeholders, the Company published its total tax contribution, making clear the significant economic and social role of the taxes paid by the Group.

In order to calculate its total tax payments, the Red Eléctrica Group uses PricewaterhouseCoopers’s Total Tax Contribution (TTC) framework, which measures the total impact derived from a Company’s payment of tax.

This appraisal is conducted in terms of the total contribution of taxes paid to the different Tax Authorities, directly or indirectly, as a result of the Red Eléctrica Group’s economic activity.

The Red Eléctrica Group’s total tax contribution for 2017 is published in the 2017 Sustainability Report.

[2] Royal Decree 1080/91 of 5 July, as amended by Royal Decree 116/2003 of 31 January on the European list of non-cooperative tax jurisdictions approved by the ECOFIN at its meeting of 5 December 2017 and the List of non-cooperative tax havens compiled by the OECD.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

6.2 Compliance

COMPLIANCE SYSTEM

Strengthening the compliance functions is a priority line of action in the Red Eléctrica Group given, amongst other circumstances, the demanding attitude of its stakeholders in relation to service excellence and to the highest ethical standards in its operation, as well as the growing geographical diversification of the Red Eléctrica Group and the progressive expansion of the scope of its activities.

Red Eléctrica has developed a Compliance System aligned with best practices in this field with the aim of supporting the organization in complying with its obligations and commitments. The purpose of the compliance function is to promote a comprehensive vision that anticipates compliance risk and ensures that it is controlled

efficiently, guaranteeing that said risk is managed on a coordinated and unified basis across the entire enterprise.

Pursuant to the Red Eléctrica Group's commitment to responsible and sustainable management, and in accordance with management best practices, the organization has a Compliance Unit that forms part of the Internal Audit and Risk Control Department. The unit is **responsible for designing, developing, implementing and monitoring the Red Eléctrica Group Compliance System.**





INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

The Red Eléctrica Group continuously fosters extending its culture of integrity to all areas of the Company as a cornerstone of due diligence in managing compliance risk.

Key actions in 2017

- Design of a specific methodology for assessing compliance risks
- Preliminary mapping of compliance risk
- Development of the Plan to build awareness and disseminate the compliance system
- Startup of the Compliance Forum
- Maximum score [100 points out of a 100] in the codes of conduct/compliance/anti-corruption and bribery section of the Dow Jones Sustainability Index 2017 for the third straight year

Assessment of compliance risks

During 2017 Red Eléctrica defined a specific methodology to assess compliance risks, aligned with the corporate methodology for risk assessment, and with the aim of having a detailed diagnosis of the inherent risks faced by the organization in compliance matters and the existing control framework for preventing those risks.

This assessment methodology has begun to be applied to the main regulatory compliance risks to which the Company is exposed, which are identified by means of the “key obligations” set out in the regulatory maps previously drawn up for each area of compliance.

PREVENTION OF CRIMINAL RISKS

Red Eléctrica has a Criminal Risk Prevention Programme aimed at identifying the rules, procedures and tools established to avoid the breach of legal rules that carry criminal liability for the Company and its employees and to adapt them to the regulatory environment. This widens the due control exercised by the Red Eléctrica Group to take in the management and prevention of criminal risks that can affect its activity and business sector under the Spanish Criminal Code [Código Penal].

The Programme, approved by the Board of Directors of Red Eléctrica at its meeting of 24 November 2011, has a control management body to supervise the compliance with the programme and to carry out specific actions to ensure it is kept up to date and executed properly.

That body is composed of the following members:

- The Ethics Officer

- Representative of the Department of Risk Control, Compliance and Quality
- Representative of the Internal Audit Department
- Representative of the Department of Organization and Human Resources Planning
- Representative of the Legal Department

This body receives reports from the Internal Audit Department which reports the results of its audits in the Criminal Risk Prevention Programme, as well as the Department of Risk Control, Compliance and Quality, the Legal Department and the Department of Organization and Human Resources Planning.

In addition, the Ethics Officer reports to the Control and Supervision Body on reports of wrongdoing received that may have criminal law implications. This body guarantees the confidentiality of all information received, as done by the Ethics Officer.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

As well as other functions that rest with the control and supervision body of the Criminal Risk Prevention Programme as body responsible for the monitoring, enforcement and updating of the programme, it periodically reports to the Audit Committee on the actions carried out, proposed improvements, updates implemented, measures agreed, and any other issues considered significant in the discharge of its functions. The Control and Supervision Office monitors the control measures associated with the prevention of criminal risks, compliance with the programme and its frequency.

PREVENTION OF CORRUPTION

The Ethics Code and the related inquiries and complaints management system, which also includes the fight against corruption, is an effective mechanism for the detection and treatment of possible cases of corruption and fraud.

In addition, in 2015 the Board of Directors approved a guide for the prevention of corruption that applies the corporate values and standards of behaviour set out in the Ethics Code that is related to the principal manifestations of corruption. All members of Red Eléctrica Group have the obligation to know and apply the content of that guide and review how they act in light of the principles, commitments and controls established there.

The above is supplemented by specific periodic checks of the processes considered susceptible to the risk of corruption and fraud. Those controls involve internal audits based on the programmes for prevention of fraud and for the prevention of criminal liability, which include specific controls for those risks.

Furthermore, Red Eléctrica's processes are integrated into systems organized in accordance with international standards [ISO 9001, ISO 14001 and OHSAS 18001] and their design has included controls to mitigate or reduce the main risks associated with those processes.

In addition to these processes, there is a system for internal control over financial reporting [ICFR] that includes controls for the risks of inappropriate use of assets and intentional misrepresentations in financial statements. The independent assurance report on that system is included as an annex to this report.

In 2017, in accordance with the standards of conduct set out in the Ethics Code, which prohibits contributions to political parties and organizations, no donations, subsidies or loans were made by the Group to political parties.

During the past year no reports of wrongdoing were received in the Ethics Channel in respect of possible cases of corruption. No company in the Red Eléctrica Group has been investigated or convicted by any court of wrongdoing in cases of corruption.

Main objectives for 2018

- Review and update of the Ethics Code of the Red Eléctrica Group to adapt it to best practices in compliance matters
- Advance in the Compliance System governance and organizational model
- Advance in the methodology for monitoring and controlling compliance risks
- Develop the plan for training, awareness building and education in the compliance culture for 2018.





- INTERVIEW
WITH THE
CHAIRMAN



- INTRODUCTION:
RED ELÉCTRICA
GROUP



01
REGULATORY
FRAMEWORK
AND CORPORATE
GOVERNANCE POLICY
AS THE EXPRESSION
OF CORPORATE
GOVERNANCE STRATEGY



02
COMMITMENT TO
DIALOGUE WITH AND
PARTICIPATION OF
SHAREHOLDERS AND
OTHER STAKEHOLDERS



03
THE BOARD OF
DIRECTORS AS THE
BODY RESPONSIBLE
FOR CONTROL AND
SUPERVISION



04
BALANCE OF POWER
IN THE BOARD OF
DIRECTORS



05
ASSESSMENT AND
REMUNERATION
POLICY



06
APPLICATION
OF THE INTEGRATED
COMPLIANCE, RISK
MANAGEMENT AND
CONTROL SYSTEM



07
LOOKING TO
THE FUTURE



- OFFICIAL ANNEX

6.3

Integrated risk management and control

6.3.1 INTEGRATED RISK MANAGEMENT SYSTEM

An Integrated risk management System has been in place in the Red Eléctrica Group since 2002 for the purpose of achieving the Group's strategies and objectives, ensuring that the risks that can affect them, including tax risks, are identified, analyzed, evaluated, managed and controlled in a systematic manner, subject to unified criteria and within the acceptable risk level approved by the Board of Directors.

The management System conforms to the ISO 31000 standard for risk management principles and guidelines and operates on a comprehensive and continuous basis. That management system

is consolidated by business unit, subsidiary and support at the corporate level.

In 2015 work started on a gradual review of the compliance of the five components of internal control, according to the COSO Integrated Framework, May 2013. At the end of 2015 the audit firm Ernst & Young (EY) reviewed the first of these components ("Control Environment") and in November 2016, the second

("Risk Assessment"). In both reviews the auditor came to the conclusion that the elements and activities relating to the control environment are formally established and in place in all areas/operations of the organization and that, furthermore, in many cases the best practices in this field have been implemented.

In 2017 EY audited the integrated risk management System and concluded that the system has been implemented in accordance with the ISO 31000 standard.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

The Red Eléctrica Group has an integrated risk management Policy and a general procedure for enterprise risk management and control, based on the COSO II Integrated Framework for Enterprise Risk Management [Committee of Sponsoring Organizations of the Treadway Commission].

Integrated Risk Management Policy

According to the Board of Directors Regulations of Red Eléctrica Corporación, approving the risk control and management policy is the responsibility of the Board of Directors.

The risk control and management policy identifies the different types of risk, sets the level of risk the Group considers acceptable and sets out action guidelines to manage and mitigate risk.

In 2015 this policy was expanded to include the Tax Risk Control and Management Policy and the action guidelines for Managing and mitigating tax risks.

This policy is fully aligned with the Group's current strategic plan and is available in the Corporate Governance section of the corporate website via the following link: [Integrated Risk Management Policy](#).

General Procedure for Integrated Risk Management and Control

The general procedure for integrated risk management and control regulates the identification, analysis, assessment and control

of the management of the material risks faced by the Group.

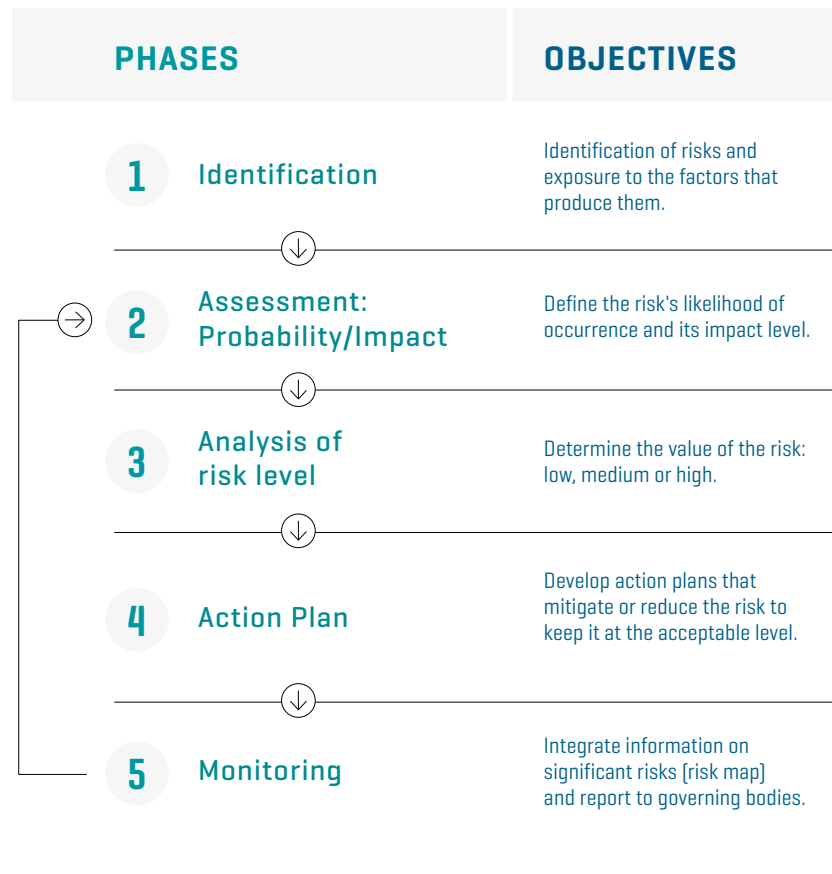
The procedure is intended to ensure that managers at all levels within the Group are aware of and assess the risks that threaten the Group's strategies and objectives, take those risks into account in their activities and keep them within the set levels of acceptable risk.

Organizational structure

The risk management System is integrated in nature, insofar as all of the Group's business units participate in it, along with the different governing bodies, within a systematized management process, in line with the criteria and guidelines established in the General Policy and Procedure for Enterprise Risk Management and Control.

The Policy and the Procedure define the different responsibilities of each of the units and governing bodies of Red Eléctrica Group and also the information flows and activities to be carried out, in accordance with the model that appears in the figure below.

INTEGRATED RISK MANAGEMENT AND CONTROL PROCESS





INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



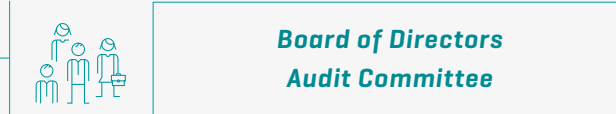
07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

ORGANIZATIONAL SCHEME

- Approve the risks policy.
- Approve criteria for acceptable risk level.
- Supervise effectiveness of integrated risk management system on half-yearly basis.



Advisory Committee to the Chairman



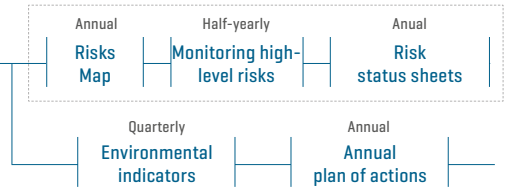
- Monitor the map of key risks
- Ensure proper control and monitoring of risk management and of the action plans

Risks Policy | Acceptable Risk Level | Management and control procedure

GUIDELINES



INFORMATION



- Support units in implementing the integrated risk management and control procedure.
- Oversee that risks are managed within an acceptable level of risk.
- Monitor the Group's risk level and the evolution of key risks.
- Assess the flow of information to the governing bodies.

- Spot and report to Internal Audit and Risk Control Department the appearance of material new risks or significant changes
- Assess material risks with support from the Internal Audit and Risk Control Department to manage those risks
- Manage activities, processes and projects according to the acceptable risk level set





INTERVIEW
WITH THE
CHAIRMAN



INTRODUCTION:
RED ELÉCTRICA
GROUP



01
REGULATORY
FRAMEWORK
AND CORPORATE
GOVERNANCE POLICY
AS THE EXPRESSION
OF CORPORATE
GOVERNANCE STRATEGY



02
COMMITMENT TO
DIALOGUE WITH AND
PARTICIPATION OF
SHAREHOLDERS AND
OTHER STAKEHOLDERS



03
THE BOARD OF
DIRECTORS AS THE
BODY RESPONSIBLE
FOR CONTROL AND
SUPERVISION



04
BALANCE OF POWER
IN THE BOARD OF
DIRECTORS



05
ASSESSMENT AND
REMUNERATION
POLICY



06
APPLICATION
OF THE INTEGRATED
COMPLIANCE, RISK
MANAGEMENT AND
CONTROL SYSTEM



07
LOOKING TO
THE FUTURE



OFFICIAL ANNEX

The Board of Directors Regulations expressly gives the **Board of Directors** responsibility for approving the Integrated Risk Management Policy of the Group. This includes setting the level of acceptable risk and receiving reports on and periodically monitoring the internal control, prevention and reporting systems. The Board reviews the risk control system and material risks, including tax risks, at least twice a year, without prejudice to the information it receives on a regular basis from the Audit Committee as part of the ongoing monitoring process carried out by that committee.

The Audit Committee is responsible for periodically supervising the effectiveness of the integrated risk management system, including tax risk, to ensure that material risks are identified, kept within the established acceptable risk levels and properly reported.

The **Advisory Committee to the Chairman**, composed of managers from the most significant and strategic areas of the Company, is assigned the functions of monitoring the material risks

map and ensuring that the risks classified as high level and other especially important risks, as well as the critical action plans to mitigate those risks, are properly controlled and monitored.

The **Internal Audit and Risk Control Department**, reporting to the office of the chairman, is responsible for coordinating and supporting the risk identification, analysis and assessment process and periodically controlling risks. This department submits the appropriate reports to the Advisory Committee to the Chairman, Audit Committee and Board of Directors.

The **organizational units** are involved in the risk management system within the process of identification, analysis and evaluation, together with the **Internal Audit and Risk Control Department** and in the implementation of action plans.

6.3.2 MAIN RISKS, TOLERANCE LEVEL AND RESPONSE SUPERVISION PLANS

Main risks that may affect the achievement of the Group's strategies and objectives

The Red Eléctrica Group's core business is the transmission of electricity and the operation of the electricity system in Spain, which are regulated activities, insofar as they are critical to the security and continuity of electricity supply and are carried out on an exclusive basis.

This classification as a regulated activity affects both the determination of revenues and the legal environment and conditions in which it has to undertake its principal activities.

The types of risks the Group faces in the pursuit of its strategies and objectives can be classified as follows:

Operational Risks:

- Operational risks that may affect the electricity system. Risks related to the correct functioning of the Transmission Network and System Operation.
- Environmental and personal safety risks. Risks related mainly to the environment in which the Group carries on its activities and the safety of the people involved in those activities.
- General security risks. This category groups together the risks related to physical security and cybersecurity.
- Other operational risks. Operational risks not included in the previous categories.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

Regulatory risks:

- Regulatory risks as Spanish TSO. Risks associated with the regulations to which the Group is subject in its role as Spanish TSO.
- Other regulatory risks arising from regulations other than those indicated above. These specifically include tax risks. Tax risks: risks arising from the application of tax regulations, difficulties in interpreting those regulations or amendments to those regulations and the possible impact the Company's management of its tax affairs could have on its reputation.

Financial and counterparty risks:

- Financial and counterparty risks. Financial risks, market risks and risks arising from the failure of counterparties to perform their contractual obligations.

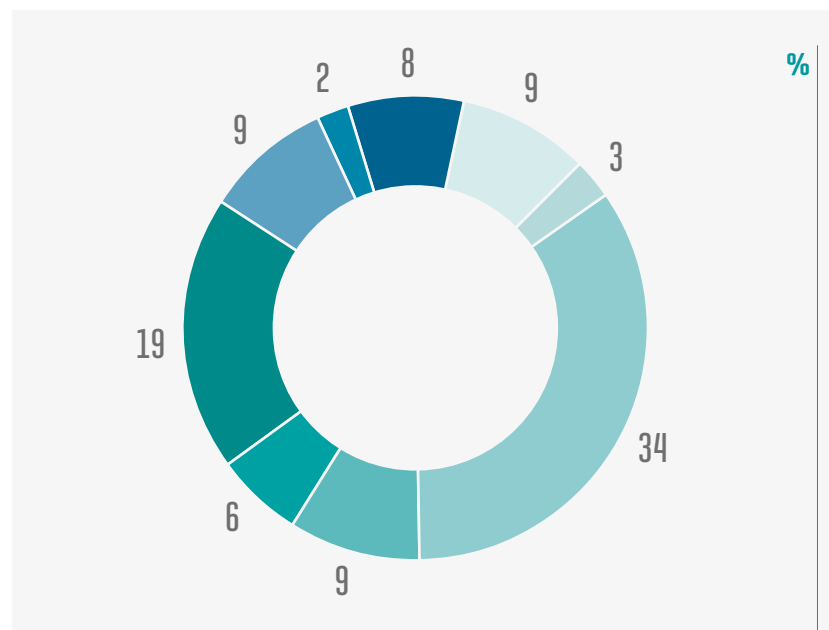
Business diversification risks:

- Risks associated with the telecommunications business.
- Business abroad risks. Groups together the risks arising in the activities carried out by the Group through its foreign subsidiaries.

Tax aspects were included in the integrated risk management

policy in 2015 and specific guidelines for managing tax risks were established.

Following the risk analysis performed by the Red Eléctrica Group, the latest Risk Map identifies 118 risks (fiscal 2016), which are shown in the following chart by risk category:



TSO Regulation 9% • Other regulation 3% • Electric system operation risks 34% Integral security 9% • Environmental and personal safety risks 6% • Other operational risks 19% Financial and counterparty risks 9% • Telecommunications risks 2% • Business abroad risks 8%

The Company's Sustainability Report provides additional detailed information on the main risks faced by the Group at present, as well as potential future risks. That report may be seen at the following link: [Sustainability Report 2017](#).

Risk tolerance level

The level of risk the Red Eléctrica Group is willing to accept is set for risks individually and risks in aggregate [overall acceptable risk level].

The Group's Risk Management System defines a methodology for setting the acceptable level of risk. All identified risks are thus classified in three categories:

- High-level risks
- Medium-level risks
- Low-level risks

To establish the level of a risk, two parameters are used: the probability of the risk occurring and the impact it would have on the Company if it did occur.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

The probability of occurrence is classified into five levels based on a specific probability distribution for each type of risk.

In terms of their impact, risks are rated on the basis of the effect they could have on four key elements of the business:

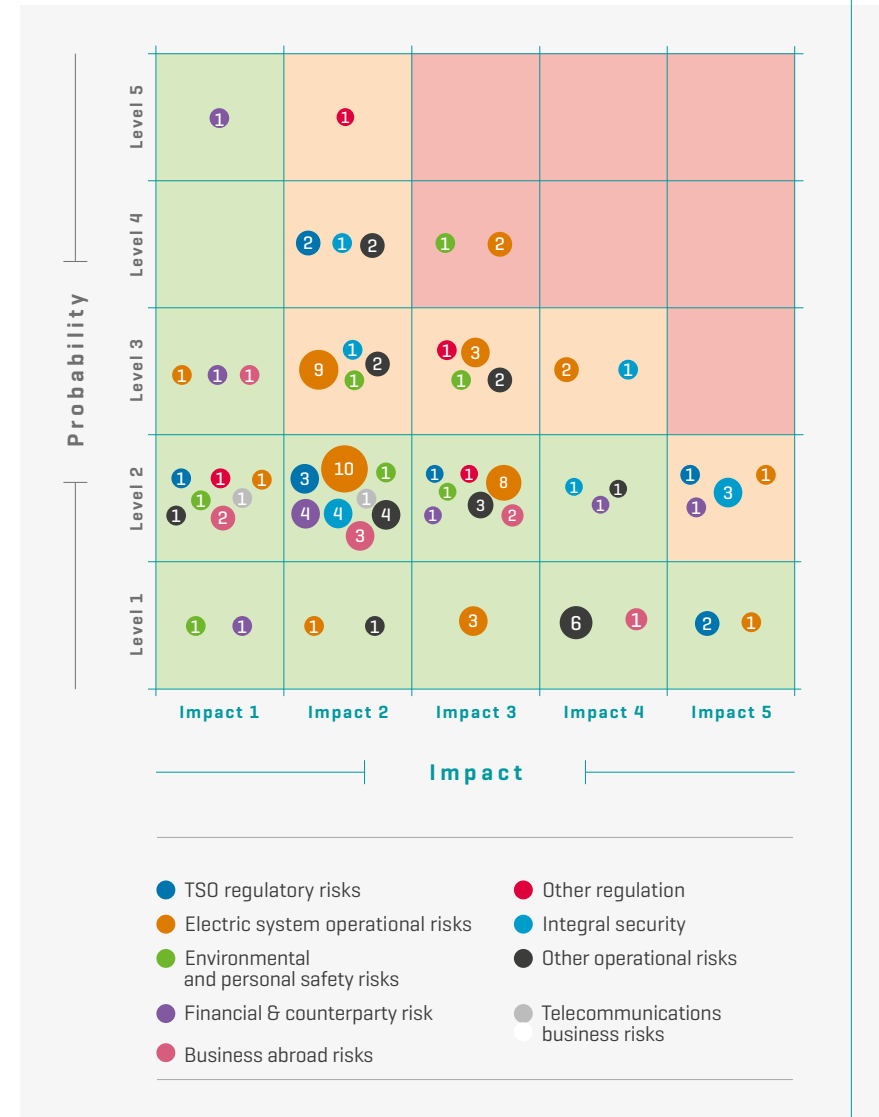
- Supply of electricity. Measured by the Energy Not Supplied (ENS) as a result of the possible event.
- The achievement of basic strategies. Degree of impact on the achievement of basic strategies.
- Reputation. Degree of impact on reputation (geographical scope, duration and reparability).
- The income statement. Impact on the income statement, before corporate income tax.

For each of these four elements, the Group has produced a table showing five levels of effect or impact. In the cases of electricity supply and the income statement, the measurement is quantitative in nature [MWh and Euros] whereas for basic strategies and reputation it is qualitative.

The position on the probability/ impact matrix, which depends on the probability of occurrence and the level of impact of each risk, automatically determines the level of risk (red box = high risk, orange box = medium risk and green box = low risk).

This following matrix reflects the distribution of the risks based on the year-end 2016 risk assessment.

RISK MATRIX





INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM

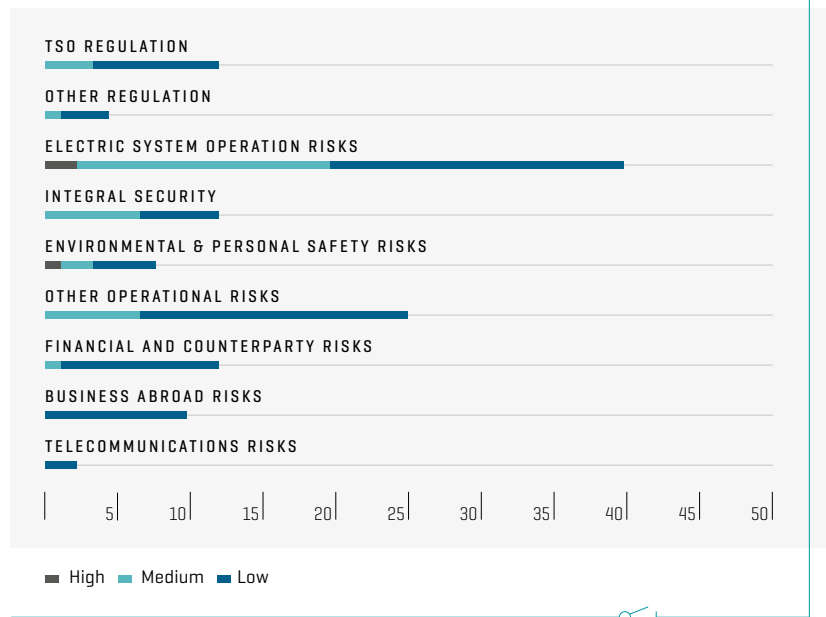


07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

Distribution of risk by category and level



According to the integrated risk management Policy, at the individual level, any risk that does not exceed the low-level classification is deemed acceptable. Risks exceeding that level must be targeted by actions to bring them to an acceptable level provided the risk is manageable and the cost of

the mitigating measures is justified by the impact the risk could have on the Group if it were to materialize. In 2016 the Board of Directors approved the Group's overall acceptable risk level for each of the aforesaid four types of impacts envisaged in the integrated risk management system (impact on electricity supply, impact on basic Group strategies, reputational impact and earnings impact).

As a general risk management rule, the Group's aggregate risk level, calculated by statistically aggregating the individual risks, must not exceed the overall acceptable risk level.

Risks that materialized in 2017

None of the risks that materialized in 2017 were significant.

The transmission network facilities are permanently exposed to operational events that can affect the continuity and security of the electricity supply.

During 2017 there were events that resulted in minor power cuts. These events are generally caused by third parties and meteorological phenomena.

The control systems responded appropriately to these events, as evidenced by the availability index of the peninsular transmission network, which in 2017 was 98.29%.

The Group also has insurance policies that limit the potential impact such events may have on the income statement.

Risk response and supervision plans for the Groups main risks

The risk identification, analysis, assessment and control process includes the actions that must be taken in order to bring the level of risk down to the acceptable level.

To monitor risks, the current integrated risk management system covers more than 500 actions plans aimed at reducing risk levels, with more than 300 indicators of the evolution of those levels.

Once every six months for high-level risks and once a year for other risks, the Internal Audit and Risk Control Department works with the management units to review the performance and impact of the pre-established action plans to reduce risk.



INTERVIEW WITH THE CHAIRMAN



INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



OFFICIAL ANNEX

In addition, the Group makes contingency plans for the various crisis situations that could ensue in the event of any electrical incident (to ensure supply security) or non-electrical incident that could affect the environment, people, the Company's ability to operate, the availability of its systems, its earnings or any other event that could affect its reputation.

The Company also has a guide for managing cyber incidents, updated in 2017, which lays down the criteria and guidelines for managing any cybersecurity incident.

In addition, the Company has a System for Internal Control over Financial Reporting (ICFR), whose purpose is to improve the efficiency and security of the

processes involved in its financial reporting, including early adoption of international best practices. The ICFR system includes the Company's tax information and processes and the associated controls.

Challenges for 2018

- Review the Risk Control Model: Structure, tools and reporting.
- Design a dashboard of risk management indicators.
- Evolve the methodology for quantitative measurement of risks.
- Review the acceptable risk levels.





- INTERVIEW WITH THE CHAIRMAN



- INTRODUCTION: RED ELÉCTRICA GROUP



01 REGULATORY FRAMEWORK AND CORPORATE GOVERNANCE POLICY AS THE EXPRESSION OF CORPORATE GOVERNANCE STRATEGY



02 COMMITMENT TO DIALOGUE WITH AND PARTICIPATION OF SHAREHOLDERS AND OTHER STAKEHOLDERS



03 THE BOARD OF DIRECTORS AS THE BODY RESPONSIBLE FOR CONTROL AND SUPERVISION



04 BALANCE OF POWER IN THE BOARD OF DIRECTORS



05 ASSESSMENT AND REMUNERATION POLICY



06 APPLICATION OF THE INTEGRATED COMPLIANCE, RISK MANAGEMENT AND CONTROL SYSTEM



07 LOOKING TO THE FUTURE



- OFFICIAL ANNEX

6.4 Internal audit

Red Eléctrica Internal Audit is an independent, objective assurance activity that involves planned systematic review of the Group's processes, systems, projects and other activities to assess and enhance their effectiveness by identifying aspects that require improvement and overseeing implementation of those improvements.

The internal audit unit reports organizationally to the chairman of the Board and functionally to the Audit Committee, and its mission, authorities, functions and duties are set out in the "Internal Audit Statute of the Red Eléctrica Group" approved by the Board of Directors.

In order for this activity to contribute greater value to the organization, the Company prepares an Annual Plan of audits focused on: key risks and their controls, internal control [control framework, ICFR system and internal control of Group subsidiaries], meeting requests from senior management, and checking the legal and internal rules and regulations, covering the legal requirements and the requirements of the management systems that have been established [quality, environment, occupational safety and health and corporate responsibility].

Audit results are reported quarterly, as is the follow-up on aspects that require improvement, to the management team, to the chairman and to the Audit Committee.

RELATIONS BETWEEN INTERNAL AUDIT AND OTHER ASSURANCE UNITS

Internal audit [third line of defence] takes into account the level of assurance provided by units with functions in the second line of defence when preparing the Annual Plan and determining the scope and focus of the audits.

In relation to risk management, the Annual Plan includes audits of the analysis and verification of the controls and actions that contribute to mitigating the most important inherent risks of the Group, reporting the results to the Risk Control area.

In relation to compliance activity, the Annual Plan envisages specific audits of the risks of criminal liability of legal persons, as well as of legal and internal compliance in the Group's processes, and reports the results to the Compliance area.

