REPORT SUBMITTED BY THE BOARD OF DIRECTORS OF IBERDROLA, S.A. REGARDING THE PROPOSED APPROVAL OF A NEW DIRECTOR REMUNERATION POLICY INCLUDED IN ITEM NUMBER ELEVEN ON THE AGENDA FOR THE GENERAL SHAREHOLDERS’ MEETING CALLED TO BE HELD ON 13 AND 14 APRIL 2018, ON FIRST AND SECOND CALL, RESPECTIVELY.

1. Object of the Report

This report has been prepared by the Board of Directors of IBERDROLA, S.A. ("Iberdrola" or the "Company") pursuant to the provisions of section 529 novodecies of the Companies Act, in order to provide a rationale for the proposed approval of a new Director Remuneration Policy, and pursuant to such section, it includes the corresponding report of the Remuneration Committee and the text of the proposal.

2. Basic Principles of the New Director Remuneration Policy

Iberdrola’s Board of Directors believes that talent, effort, creativity and leadership are the main elements capable of differentiating the performance of Iberdrola from the other companies in the electric industry.

The new Director Remuneration Policy proposed by the Remuneration Committee seeks to be a tool to ensure the presence of all of these elements within the Company’s board of directors. It has been designed to attract and retain the best board members, incentivise their effort, encourage their creativity and leadership, and ensure that their interests are always aligned with those of Iberdrola’s shareholders.

For this purpose, the policy being submitted for approval of the shareholders at the General Shareholders’ Meeting is based on the following principles:

a) Market remuneration, which captures and retains talent: it should provide appropriate remuneration for the dedication and responsibility assumed by the directors, in accordance with that paid in the market at comparable companies, for which purpose the company will perform regular comparative analyses.

b) Focused on maximising the creation of value, committed to the Mission, Vision and Values of the Iberdrola group: it must constitute a lever to maximise shareholder return and Iberdrola’s social dividend.

c) Focused on goals, aligned with the Company’s strategy: it should serve the strategic goals defined from time to time by the Board of Directors. For this purpose, the system of setting financial and non-financial goals linked to remuneration should be transparent, pre-determined, quantifiable, and with a proper balance between the weight of short-term variable remuneration and that of long-term remuneration.

d) That avoids potential conflicts of interest: variable remuneration should be limited to the executive directors to avoid potential conflicts of interest that might affect non-executive directors.

e) Clear and transparent: the Company’s Board of Directors assumes the commitment to give effect to the principle of full transparency of all items of remuneration received by all of the directors, supplying transparent, individualised and adequate information issued sufficiently in advance and aligned with good governance recommendations that are generally accepted in the international markets regarding director remuneration.

3. General Description of the New Director Remuneration Policy

The outlines of the new Director Remuneration Policy are similar to those of the Policy currently in effect, although they include certain improvements, which are the result of Iberdrola’s ongoing effort to strengthen its leadership in the area of corporate governance:

a) More information on the parameters of variable remuneration: there is a description of the parameters to which the variable remuneration of the executive directors will be linked, which are different for each director, expressly establishing their link to the achievement of the objectives contemplated in the outlook approved by the Board of Directors and communicated to the financial community.

b) Specific objectives: the proposal provides for the establishment of specific objectives for each financial year, the level of compliance with which will be regularly reported in the Annual Director Remuneration Report.

c) Non-financial parameters – social dividend: the new policy includes the challenges in the fight against climate change and relations with Iberdrola’s various stakeholders among the parameters on which variable remuneration will depend.
**d)** **Long-term horizon:** the proposal contemplates the long-term system (six years) of variable remuneration in shares approved by the shareholders at the 2017 General Shareholders’ Meeting (2017-2019 Strategic Bonus).

**e)** **Holding period for shares delivered:** the executive directors may not transfer the shares received under the long-term variable remuneration systems for a period of three years, unless they are the direct or indirect owners of a number of shares equal to two times their annual fixed remuneration or the Board of Directors so approves under exceptional circumstances.

**f)** **Malus and claw-back clauses:** the Board of Directors, upon a proposal of the Remuneration Committee, may cancel the payment of long-term variable remuneration (*malus* clauses) or demand the return of remuneration already paid (claw-back clauses) under special circumstances (fraud, serious violation of law, and in the event of a material restatement of the financial statements on which the evaluation of the performance level was based).

It also has the power to suspend the payment of short-term variable remuneration if the beneficiary has committed a serious breach of the *Code of Ethics* without having cured the results of such breach.

4. **Proposed Resolution Submitted to the Shareholders at the General Shareholders’ Meeting**

The proposed resolution submitted to the shareholders for approval at the General Shareholders’ Meeting reads as follows:

**ITEM NUMBER ELEVEN ON THE AGENDA**

Approval of a new Director Remuneration Policy.

**RESOLUTION**

To approve the Director Remuneration Policy, the full text of which, together with the required report of the Remuneration Committee, are included in the report of the Board of Directors made available to the shareholders as part of the documentation relating to the General Shareholders’ Meeting from the date of publication of the announcement of the call to meeting.”
ANNEX

REPORT PREPARED BY THE REMUNERATION COMMITTEE ON THE PROPOSED NEW DIRECTOR REMUNERATION POLICY

Pursuant to the provisions of article 3.a) of the Regulations of the Remuneration Committee of IBERDROLA, S.A. (“Iberdrola” or the “Company”), the Remuneration Committee (the “Committee”) is to propose to the Board of Directors the director remuneration policy to be submitted for approval of the shareholders at a General Shareholders’ Meeting.

In the exercise of this power, the Remuneration Committee has designed a proposed Director Remuneration Policy, which seeks to be an efficient tool to attract the best candidates for director and to retain them once appointed, to incentivise their efforts and their diligent activity, encouraging their creativity and leadership, and ensuring that their interests are aligned with the commitment of Iberdrola to its mission, its vision and its values, inasmuch as these elements are the ones that allow for Iberdrola’s performance to be differentiated from other companies in the electric industry.

The Remuneration Committee finds that the proposed Director Remuneration Policy being submitted to the Board of Directors meets this function, as well as the recommendations of the Good Governance Code of Listed Companies approved by the National Securities Market Commission on remuneration, and with good governance recommendations that are generally accepted in the international markets regarding director remuneration.

The text of the proposed new Director Remuneration Policy is as follows:

DIRECTOR REMUNERATION POLICY

In exercise of the powers vested therein, the Board of Directors of IBERDROLA, S.A. (“Iberdrola” or the “Company”), upon a proposal of the Remuneration Committee, hereby submits this Director Remuneration Policy for approval of the shareholders at the General Shareholders’ Meeting of the Company.

1. Purpose and Basic Principles

1.1 Mission, Vision and Values of the Iberdrola group

The driving principle of the Mission, Vision, and Values of the Iberdrola group is its commitment to the sustainable creation of value in the performance of all of its activities for society, its professionals, its customers, its suppliers, its shareholders and other stakeholders.

This commitment governs the day-to-day activities of the Company, channels its leadership role in its various areas of activity, focuses its strategy of maximising social dividends and guides the ethical behaviour of all personnel participating in the daily construction of Iberdrola’s business enterprise, starting with its management body.

In this regard, the ultimate goal of the Director Remuneration Policy is to help develop the Mission, Vision and Values of the Iberdrola group such that the remuneration of the Company’s directors is commensurate with the dedication and responsibility assumed, taking into consideration the Company’s desire to lead the energy sector. This desire is based on aspects like the provision of a high-quality service through the use of environmentally-friendly energy sources, innovation, digital transformation in its area of activity, the fight against climate change, and commitment to a social dividend and the generation of employment and wealth in its surroundings.

1.2 Basic Principles

The Board of Directors has found proper decision-making and a clear commitment to the corporate values are two of the main principles determining the performance of companies, particularly in the energy sector: all of them can choose similar businesses, markets and technologies, but their performance is different, based on the principal differentiating elements of talent, efforts, creativity, leadership and the ability to translate one’s commitment into a mission, vision and values.

Within this context, the basic principles governing this Director Remuneration Policy are the following:

a) Provide suitable remuneration for the dedication and responsibility assumed by the directors, in line with the market remuneration paid by companies with comparable capitalisation, size, ownership structure and international scope. This will be essential for recruiting and retaining the best candidates.
To this end, the Remuneration Committee periodically engages in a benchmark analysis of remuneration systems applicable to comparable companies at the international level.

b) Align the remuneration policy of the Company as a whole with its values, with its commitment to maximise its social dividend and with shareholder return, as these terms are defined in the By-Laws, within the framework of the commitment of the Iberdrola group to all of its Stakeholders.

c) Ensure that the remuneration helps to achieve the strategic goals of Iberdrola, which are periodically published.

1.3. Principles Governing the Remuneration of the Executive Directors

As regards the executive directors, the Director Remuneration Policy follows the same standards as the Senior Officer Remuneration Policy and shares the same principles and guidelines as the remuneration policy for all employees of the Company: a commitment to the Mission, Vision and Values of the Iberdrola group, personal and corporate ethics, excellence in hiring, continuous training, gender equality, meritocracy and recognition of talent, reconciliation, and relevancy of the variable component of the remuneration package.

In particular, the main principles governing the remuneration of the executive directors are the following:

a) Ensure that the remuneration, in terms of structure and total amount, is in line with best practices, as well as competitive vis-à-vis that of comparable entities at the domestic and international level, taking into account the situation of the regions in which the Group operates.

b) Establish the remuneration in accordance with objective standards based on individual performance and on the achievement of the business objectives of the Company and the Group.

c) Include a significant annual variable component tied to performance and to the achievement of specific, pre-established, quantifiable objectives in line with the corporate interest, the Mission, Vision and Values of the Iberdrola group and the strategic goals of the Company. The application of this Director Remuneration Policy shall take into consideration economic/financial, operational/industrial and corporate social responsibility parameters for these purposes.

d) Foster and encourage the attainment of the strategic goals of the Company through the inclusion of long-term incentives, strengthening continuity in the competitive development of the Group, of its directors and of its management team, and generating a motivating effect that acts as a driving force to ensure the loyalty and retention of the best professionals.

e) Set appropriate maximum limits to any variable remuneration as well as suitable mechanisms in order for the Company to be able to obtain reimbursement of the variable components of remuneration if the payment has not conformed to the terms of performance or if such variable components have been paid based on information later shown to be inaccurate.

2. Overall By-Law Limitation on Director Remuneration

Pursuant to article 48.1 of the By-Laws, the amount that the Company allocates annually to the directors as remuneration is limited to a maximum amount equal to 2% of the consolidated group profits obtained during the financial year, after covering legal and other mandatory reserves and the issuance to the shareholders of a dividend of at least 4% of the share capital.

This limit includes the amount corresponding to the executive directors for the performance of executive duties, as well as the endowment of funds to meet the obligations of the Company regarding pensions, the payment of life and casualty insurance premiums, coverage for and payment of severance compensation in favour of current and former directors, and the operational costs of the Board of Directors and the committees thereof.

For the purpose of establishing such limit, the quoted price of shares or options thereon or remuneration indexed to the listing price of the shares shall not be calculated, which remuneration shall in all cases require the approval of the shareholders at a General Shareholders’ Meeting.
3. **Competent Bodies**

Within the by-law framework referred to above, the shareholders acting at a General Shareholders’ Meeting are vested with the power to approve this *Director Remuneration Policy*, which constitutes the Company’s highest-level rules on remuneration after the By-Laws.

Within the overall limit established in the By-Laws and in accordance with the provisions of law and this *Director Remuneration Policy*, the Board of Directors, upon a proposal of the Remuneration Committee, is vested with the power to specify the remuneration of the directors, except for remuneration consisting of the delivery of shares of the Company or of options thereon, or remuneration indexed to the value of the shares of the Company, which must be approved by the shareholders acting at a General Shareholders’ Meeting.

4. **Structure of the Remuneration of Directors in their Capacity as Such**

The remuneration to which directors are entitled in their capacity as such is structured in accordance with the following standards within the framework of legal and by-law provisions:

4.1. **Fixed Amount**

Directors receive a fixed annual amount that is commensurate with market standards, in keeping with the positions they hold on the Board of Directors and in the committees on which they sit, always taking into account the overall by-law limit on director remuneration set forth in section 2 above.

The fixed remuneration of the directors in their capacity as such is included within the limit reflected in section 2 of this Policy, which also includes the remuneration of the executive directors for the performance of their executive duties, as well as the funding of pensions, the payment of life and casualty insurance premiums, coverage for and payment of severance compensation, and the operational costs of the Board of Directors and the committees thereof. The maximum amount of the annual remuneration to be paid to all directors in their capacity as such is 7,000 thousand euros.

4.2. **Coverage of Risk and Civil Liability Benefits**

The Company pays the premiums under insurance policies that it has taken with certain insurance companies for the coverage of the death or disability of directors caused by accidents, and the Company itself assumes coverage of benefits for the death or disability of directors due to natural causes. Furthermore, the Company pays the premiums under insurance policies providing coverage against civil liability deriving from holding the office of director.

4.3. **Non-competition**

External non-proprietary directors who cease to hold office prior to the expiration of the term to which they were appointed, if such cessation is not the consequence of a breach attributable thereto or exclusively due to the director’s own decision, may not hold office in management decision-making bodies of companies within the energy industry or of other competitor companies or participate in any other way in the management thereof or in the provision of advice thereto for the remaining term of their appointment (with a maximum of two years).

Non-executive directors who cease to hold office due to the provisions of the succession plan included in the *General Corporate Governance Policy* shall not be subject to any non-compete commitment, nor shall they have the right to receive any compensation for the cessation from office. This right shall also not be held by directors who cease to hold office voluntarily or as a result of a breach of their duties.

In other cases, the compensation to which external non-proprietary directors are entitled for the non-compete commitment shall be equal to 90% of the fixed amount that the director would have received for the remainder of the director’s term (assuming that the annual fixed amount that the director receives at the time of cessation from office is maintained), with a maximum equal to two times 90% of such annual fixed amount.

5. **Structure of Remuneration of Executive Directors for the Performance of Executive Duties**

The remuneration that executive directors are entitled to receive for the performance of executive duties at the Company (i.e. other than the duties inherent in their status as members of the Board of Directors) is structured as follows:
5.1. Fixed Remuneration

This portion of the remuneration shall be in line with the remuneration paid in the market by companies with comparable capitalisation, size, ownership structure and international scope.

In 2018, the chairman & CEO will have the right to receive annual fixed remuneration of 2,250 thousand euros, and the Business CEO will have the right to receive 1,000 thousand euros.

The remuneration of the executive directors will change based on the specific responsibilities and nature of the functions performed and will be reviewed annually by the Board of Directors upon a proposal of the Remuneration Committee.

For these purpose, this Committee may rely on external advisors to perform the market studies and analyses that it deems appropriate.

5.2. Short-term Variable Remuneration

A portion of the remuneration of executive directors (and of that of officers and employees) is variable, in order to strengthen their commitment to the Mission, Vision and Values of the Iberdrola group and its strategic goals and to incentivise the best performance of their duties. The maximum variable remuneration for each year will be that which is stipulated in the Annual Director Remuneration Report.

The targets to which the remuneration of the chairman & CEO will be linked shall be those reflected in the Annual Director Remuneration Report, and will be related to parameters such as:

- Net Profit, Gross Operating Profit (EBITDA), cash flow, etc.
- Shareholder remuneration compared to other securities and indices.
- Development and application of the Stakeholder Relations Policy and commitment to the social dividend.
- Equality policies.
- Commitment and results in the fight against climate change in line with what was approved by the shareholders at the General Shareholders’ Meeting 2017.
- Management of corporate reputation, measured by the Company’s presence on sustainability and ethics indices.
- Promotion of good governance and best practices.

For other executive directors, the targets to which his variable remuneration will be linked will be those relating to parameters such as:

- Net Profit, Gross Operating Profit (EBITDA), cash flow, etc.
- Level of the Group’s efficiency level measured by operating expenses over gross margin.
- Selection and implementation of profitable investments that create value.
- Levels of occupational safety and labour climate.

In each Annual Director Remuneration Report, the Company shall report on the implementation of this Policy and on the specific goals for each financial year and the level of achievement thereof.

The Remuneration Committee shall evaluate the performance of each of the executive directors, for which purposes it may rely on the advice of an independent expert, and shall submit a reasoned proposal to the Board of Directors for approval thereof.

The Board of Directors shall have a margin of discretion in evaluating compliance with the indicators, based on a proposal made by the Remuneration Committee, taking into account regulatory uncertainty, among other factors.
5.3. Long-term Variable Remuneration: Share Delivery Plans

The Company has a long-term incentive plan in effect directed towards employees who, due to their position or responsibility within the Group, are considered to contribute decisively to the creation of value, and towards the executive directors, consisting of the delivery of shares linked to the performance of the Group in relation to the development of the Outlook 2016-2020 and subsequent updates thereof approved by the Board of Directors.

Share delivery plans are subject to approval by the shareholders at a General Shareholders’ Meeting, who also set the objective and quantifiable parameters determining the accrual thereof as well as their relative weighting. The shareholders at the General Shareholders’ Meeting held on 31 March 2017 approved the 2017-2019 Strategic Bonus along these lines.

The parameters include economic/financial and comparative total shareholder return, operational/industrial and corporate social responsibility variables, and must in any case be consistent with the strategy of the Company determined by the Board of Directors, with a minimum level beyond which they are considered to be achieved and a target to reach the highest grade.

The Remuneration Committee evaluates performance and determines compliance with pre-established parameters. The committee may seek the advice of an independent expert for this purpose. The proposal thereof shall be submitted to the Board of Directors for approval.

The plans typically have a duration of six years, of which the initial three-year period is the period for evaluating the performance level compared to the parameters to which the plan is linked, and the next three years are the payment period during which the shares are delivered on a deferred basis.

In order to engage in a proper overall evaluation of performance, circumstances occurring after the approval of each of the plans having a material impact, either positive or negative, on the Outlook 2016-2020 and subsequent updates thereof or on the main economic/financial variables of the Company (corporate transactions, mergers, split-offs, acquisitions, extraordinary dividends, etc.) shall be taken into account.

At the end of the evaluation period for each of the incentive plans, the plan shall accrue annually in equal parts (in the case of the 2017-2019 Strategic Bonus, the accrual shall occur during the first half of 2020 and during the first quarter of 2021 and 2022). Each annual accrual and the corresponding payment thereof must be approved by the Board of Directors, after a report from the Remuneration Committee.

In this connection, during each of the three years of the payment period and for each delivery of shares, it is expected that there will be an evaluation whether to confirm or totally or partially cancel the corresponding payment and, if applicable, to claim the total or partial reimbursement of the shares already delivered (or the amount thereof in cash) under certain circumstances. The shares shall be delivered along with the remuneration corresponding to said shares that has accrued since the initial allocation thereof to the beneficiaries.

Furthermore, executive directors who are beneficiaries of the incentive plans may not transfer ownership of the shares received for a period of three years unless they are the direct or indirect holders of a number of shares equal to two times their annual fixed remuneration or unless the Board of Directors so approves under exceptional circumstances.

5.4. Remuneration for holding the position of director at other companies of the Group that are not wholly owned

Executive directors and officers of the Group who hold the position of director at companies that are not wholly owned, either directly or indirectly, by the Company, may receive remuneration corresponding to the position from said companies in accordance with their corporate governance rules on the same terms as the other directors.

5.5. Neutrality

The Board of Directors shall ensure that variable remuneration of any kind may not be based merely on the general performance of the markets, of the industry in which the Company operates or on other similar circumstances.

5.6. Benefits

The remuneration system for executive directors may be supplemented by health and life insurance, in line with practices in the market by companies with comparable capitalisation, size, ownership structure and international scope.
The Company does not currently have any commitment to provide defined contributions or defined benefits to any retirement or long-term saving system of any director.

5.7. Malus and Claw-Back Clauses

The Board of Directors, with due regard to any proposal made by the Remuneration Committee, has the power to cancel the payment of long-term variable remuneration (malus clause) or to request the return of remuneration already paid (claw-back clauses) under special circumstances. These circumstances include fraud, serious violation of the law and a material restatement of the financial statements on which the Board based the evaluation of the performance level, provided that said restatement is confirmed by the external auditors and is not due to a change in accounting rules.

The Board of Directors also has the power to suspend the payment of short-term variable remuneration if the beneficiary thereof has seriously breached the Code of Ethics without having remedied the consequences of said breach.

In the case of the Strategic Bonus, the power to demand a return of shares delivered shall be governed by a resolution of the shareholders acting at a General Shareholders’ Meeting and the provisions of the rules implementing said resolution and approved by the Board of Directors, after a report from the Remuneration Committee.

The proportion of the amounts to be withheld or recovered shall be determined in the discretion of the Board of Directors, after an opinion of the Remuneration Committee, based on the specific circumstances giving rise to the demand.

5.8. Severance Clauses

Since the end of the 1990s, the executive directors, as well as a group of officers, have the right to receive severance compensation in the event of termination of their relationship with the Company, provided that such termination is not the consequence of a breach attributable thereto or of the sole decision thereof. In the case of the chairman & CEO, he is entitled to three times annual salary. Any reduction in the number of annual salary payments to this group might entail a high cost for the Company, for which reason the Board of Directors has decided not to change the current status quo, given the average age of the affected group and the practically non-existent execution of these types of guarantees. Each annual director remuneration report describes the ongoing reduction in the number of affected persons and any payment of this type of severance in each financial year. Since 2011, a severance limit of two times annual salary applies to new contracts with executive directors and senior officers, as well as the Group’s Business CEO.

5.9. Appointment of New Executive Directors

To the extent possible, the remuneration of new executive directors shall be in line with the remuneration policy for the current executive directors. The fixed remuneration of the new executive directors shall be set at the time of their appointment taking into account market terms and comparable positions as well as their experience level. New executive directors shall participate in annual long-term incentives based on the same principles as the current ones. The Board of Directors, after taking account of the recommendation of the Remuneration Committee, reserves the right to deviate from established practice to the extent necessary to ensure the hiring of appropriate candidates, in view of the Company interest.

6. Adjustment to Economic Situation and International Environment

The application of this Policy shall be appropriately adjusted to conform to the economic situation and international environment, upon a proposal of the Remuneration Committee, which may rely on the advice of an independent expert to this end. If appropriate, all of the details of and reasons for any adjustment shall be provided to the shareholders in the next published annual director remuneration report.

7. Basic Terms of the Contracts with Executive Directors

a) Indefinite duration

The contracts with executive directors of the Company are of indefinite duration, and financial compensation is contemplated therein, as set out in sections 5.8 and 7.d), in the event of termination of the contractual relationship with the Company, provided that such termination does not occur exclusively due to the decision of the executive directors to withdraw or as a result of a breach of their duties.
b) Applicable legal provisions

The contracts with executive directors are governed by the legal provisions applicable in each case.

c) Compliance with the Company’s Corporate Governance System

Executive directors have the duty to strictly observe the rules and provisions contained in the Company’s Corporate Governance System, and especially, given the significance thereof, the principles and guidelines set out in the Preamble and in the Preliminary Title of the By-Laws, as well as in the Code of Ethics, which in any case shall be the reference point for the proper interpretation of the provisions of this Director Remuneration Policy.

d) Non-competition

Given the scope of their knowledge of the design and execution of the Company’s strategy and business plans, the contracts with executive directors in all cases establish a duty not to compete with respect to companies and activities that are similar in nature during the term of their relationship with the Company and for a period of between one and two years thereafter. As consideration for such commitments, the executive directors are entitled to a severance payment equal to the remuneration for such period.

e) Confidentiality and return of documents

There is a rigorous duty of confidentiality both during the term of the contracts and after the relationship has terminated. In addition, upon termination of their relationship with the Company, the executive directors must return to the Company any documents and items in their possession relating to the activities carried out thereby.

8. Principle of Full Transparency

The Board of Directors of the Company assumes the commitment to enforce the principle of the fullest transparency of all the items of remuneration received by all directors, providing clear and adequate information as much in advance as required and in line with the good governance recommendations generally recognised in international markets in the area of director remuneration.

For such purpose, the Board of Directors establishes this Director Remuneration Policy and ensures the transparency of director remuneration by including in the Company’s annual report a detailed breakdown, according to positions and status, of all remuneration received by the directors, whether as such, in their capacity as executives, if applicable, or in any other capacity, and whether such remuneration has been paid by the Company or by other companies of the Group.

In addition, the Board of Directors prepares the Annual Director Remuneration Report on an annual basis, which is made available to the shareholders upon the call to the General Shareholders’ Meeting and is submitted to a consultative vote as a separate item on the agenda.