REPORT BY THE REMUNERATION COMMITTEE OF INTERNATIONAL CONSOLIDATED AIRLINES GROUP, S.A. IN RELATION TO THE DIRECTORS' REMUNERATION POLICY PROPOSAL SUBMITTED UNDER <u>ITEM 6.b)</u> ON THE AGENDA FOR THE APPROVAL OF THE SHAREHOLDERS' MEETING CALLED FOR 17 JUNE 2015, ON FIRST CALL, AND FOR 18 JUNE 2015, ON SECOND CALL

The Remuneration Committee (the "**Committee**") of the Board of Directors of International Consolidated Airlines Group, S.A. ("**IAG**" or the "**Company**") has issued this report in relation to the Directors' remuneration policy proposal of the Company that is submitted to the binding vote of the General Shareholders' Meeting, according to the provisions of article 529 novodecies of the Spanish Companies Law (*Ley de Sociedades de Capital*).

1. <u>REGULATORY FRAMEWORK</u>

IAG, as a Spanish incorporated company, is subject to Spanish corporate law. The Spanish legal regime regarding directors' remuneration has been recently modified. Law 31/2014, of December 3, amending the Companies Law to improve corporate governance, published on December 4, establishes a legal framework substantially parallel to that of the UK as far as directors´ remuneration disclosure and approval requirements are concerned.

Spanish companies will continue to prepare their Directors' Remuneration Report in accordance with Circular 4/2013 of the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores)* until the relevant regulations are adjusted pursuant to this new law. The 2014 Spanish Directors' Remuneration Report of the Company ("**Spanish DRR**") drafted according to the relevant legislation is also available on the Company's website and is submitted to the consultative approval of the General Shareholders' Meeting under item 6.a) of the agenda.

Having said this, it is the Company's intention once again to comply voluntarily with all reporting aspects of the UK legislation of 2013 and to follow best practice UK standards, for the benefit of its key institutional shareholders and its UK shareholder base. Therefore, the Company has prepared a Directors' Remuneration Report in accordance with UK legislation information requirements (the "**UK DRR**"). This report is part of the 2014 annual report of the Company, also available on the Company's website.

Additionally, bearing in mind that the annual Shareholders' meeting is subject to Spanish corporate law, we have ensured that both reports, the Spanish DRR and the UK DRR, are totally consistent. At the Company's next General Shareholders' Meeting, the vote on the remuneration policy will be binding, according to the provisions of Article 529 novodecies of the Companies Law and the vote on the remuneration implementation report (vote on the Spanish DRR) will be advisory, according to the provisions of article 541 of the Companies Law.

The Spanish DRR is divided into five sections, in accordance with the mentioned Circular 4/2013: A) The Company's remuneration policy for the current financial year; B) Remuneration policy provided for future years; C) Overall summary of how the remuneration policy was applied during the financial year reported; D) Description of the individual remuneration earned by each of the directors; and E) Other information of interest.

The UK DRR is split into two sections. The first section is the Company's proposed future remuneration policy, including the objectives and operation of each element of pay, the context in which decisions for this policy were made, and service contract details. The second section gives the detail of the implementation of the 2014 remuneration policy including the total remuneration (a "single figure") of the Directors, and variable pay awarded in the year. It also gives details on how 2015 remuneration policy will be implemented.

The Directors' remuneration policy of the Company that is subject to the binding vote of the General Shareholders' Meeting covers the first section of the UK DRR to which a detailed explanation on the 2015 remuneration policy implementation is attached, which corresponds to sections A and B of the Spanish DRR, giving the necessary explanations in this report.

2. GENERAL OVERVIEW

IAG's executive remuneration framework aims to underpin the business objectives and financial targets, and the remuneration policy is designed to deliver total remuneration which is market competitive with increased emphasis placed on pay for performance.

IAG Group results show continued improvement despite difficult trading conditions. Both the long term incentive plan and the annual incentive plan had stretching targets set, and there has been solid progress against these targets.

The Company very much values shareholders' comments and support for the 2013 Remuneration Report submitted to shareholders' consideration at 2014 Annual Shareholders' Meeting. The Committee saw this as a great vote of confidence in the fact that the IAG Group has got a robust remuneration policy.

3. OVERALL SUMMARY OF 2014

2014 has seen continued improvement of the performance, with profitability much increased compared to 2013, and a continuing growth in the share price.

The performance share plan awarded to executives in 2012 reached the end of its performance period in December 2014, and has vested at 85 per cent of the maximum. This is a great success story, and shows a great turnaround in the Group's performance over the last three years.

The financial targets for the 2014 annual incentive plan set at the beginning of the year were stretching, but strong performance means that the two-thirds portion linked to financial performance will pay out 97 per cent of the maximum opportunity. The Group has achieved significant success in continuing to find synergies, and has outperformed against cost and revenue synergy targets. These successes will be rewarded to those involved through the personal one-third portion of the annual incentive award. The Committee will continue to ensure that executive remuneration underpins the business strategy and is confident that the overall reward framework for 2015 and beyond is in the best interests of shareholders.

4. COMPARISON OF OVERALL PERFORMANCE AND PAY

The Committee is aware of the challenging economic environment and its potential impact on the Company's finances, but it also recognises that it is very important to incentivise and retain management to drive business performance.

During the year, the Committee kept fully abreast of remuneration developments in the external marketplace. The Committee considered that the overall remuneration framework continued to be appropriate for IAG.

In deciding the remuneration policy, the pay and employment conditions in both the Spanish and UK markets were taken into account. Other key metrics considered when deciding pay and remuneration policy include company affordability, market movements, and retention considerations.

The Committee is satisfied that the compensation packages, which are set by reference to market based salary and incentive pay levels and take account of the Company's Key Performance Indicators, do not raise any social, governance or environmental risks by inadvertently motivating irresponsible behaviour or undue risk taking.

5. 2015 NEW FEATURES

One of the key activities for the Committee during 2014 has been reviewing the remuneration strategy, and one of the results of this will see a further strengthening of the alignment between executives and shareholders. This has partly been driven by feedback from investors and revisions to the UK Corporate Governance Code published on September 2014.

The new features introduced in the 2015 implementation of the remuneration policy are as follows:

- A new metric (Return on Invested Capital (RoIC)) has been introduced in the long term incentive plan, in addition to the existing metrics of EPS and relative TSR.
- Introduction of an additional holding period in the long term incentive plan.
- A strengthening of the malus and clawback provisions.

- A strengthening of the shareholding guidelines. The CEO of IAG is required to build up and maintain a shareholding of 250 per cent of basic salary (previously 100 per cent of basic salary), and the remaining Executive Directors are required to build up and maintain a shareholding of 150 per cent of basic salary (previously 100 per cent of basic salary). Executives will be required to retain the entire 100 per cent of shares (net of tax) (previously 50 per cent) which vest from share plans until their respective shareholding requirement is attained.

6. CRITERIA USED TO ESTABLISH THE COMPANY'S REMUNERATION POLICY

The Company's executives' remuneration policy is to provide total remuneration packages which are market competitive, linked to the business strategy and take into account each individual's role, skills and contribution. The Company's primary comparator group is the FTSE 26 to 100 (excluding financial services), with a secondary reference to Ibex-35 and to global airline companies where appropriate. The Committee is updated on pay and conditions of the employees within the Group, and takes this into account when determining the Executive Directors' remuneration.

Fees for Non–Executive Directors are set with reference to market positioning (primarily the Ibex-35 and the FTSE 26 to 100, excluding financial services). To acknowledge certain key roles at Board level, fees are set separately for the Non-Executive Chairman and the Non-Executive Deputy Chairman. There is also an additional fee paid to any Non-Executive Director for holding a committee chairmanship.

Non-Executive Director fees will take into account external market conditions to ensure it is possible to attract and retain the necessary talent.

7. INCENTIVES CREATED BY THE COMPANY IN THE REMUNERATION SYSTEM IN ORDER TO REDUCE THE EXPOSURE TO EXCESSIVE RISKS AND TO ADAPT IT TO THE COMPANY'S LONG-TERM OBJECTIVES, VALUES AND INTERESTS.

A significant portion of the Company's total remuneration package is variable, with emphasis placed on longer-term reward to align closely Executive Directors' and Senior Managers' interests with shareholder interests. At minimum levels, the annual incentive and the PSP pay out zero. At on-target performance, both the annual incentive and the PSP pay out 50 per cent of the maximum opportunity.

The Company has put in place a number of steps to reduce risks. The main actions are as follows:

- *Deferral*. Half of any annual incentive plan pay-out is deferred into shares, under the Incentive Award Deferral Plan.

- *Additional holding period in the PSP*. There will be an additional holding period of two years in the Performance Share Plan in accordance with the amendments introduced this year. This means that Executives will be required to retain the shares acquired from PSP awards for a minimum of two years following the end of the performance period. This is to strengthen the alignment between Executives and shareholders.

- *Shareholding Requirements*. The CEO of IAG is expected to build up and maintain a shareholding of 250 per cent of basic salary, and the remaining Executive Directors are expected to build up and maintain a shareholding of 150 per cent of basic salary. Executives will be required to retain the entire 100 per cent of shares (net of tax) which vest from share plans until their respective shareholding requirement is attained. Again, this will reinforce alignment with shareholders' interests.

- *Malus and Clawback Provisions*. Following the Committee's advice, the Board, , has authority under the malus provisions of the Performance Share Plan and the Incentive Award Deferral Plan to reduce or cancel awards before they vest, and authority under the clawback provisions of the Performance Share Plan to recover payments after vesting, if special circumstances exist. These special circumstances include fraud; material breach of any law, regulation or code of practice; misstatement of results; misconduct; failure of risk management; or any other circumstances in which the Directors consider it to be in the interests of shareholders for the award to lapse or be adjusted.

  For the PSP, clawback provisions apply during the two years' additional holding period. For the IADP, there will be three years from the date of award in which shares can be withheld, i.e. the entire period from the date of the award until vesting. For the cash element of the annual incentive plan, clawback provisions apply for three years from the date of payment. The proportion of an award to be withheld or recovered will be at the discretion of the Board taking into account all relevant matters.

8. PROCESS FOR DETERMINING THE REMUNERATION POLICY

The Committee's composition, competencies and operating rules are regulated by article 25 of the IAG Board of Directors' Regulations. A copy of these Regulations is available on the Company's website.

The Committee has the following powers to report, advise and propose:

a) To propose to the Board of Directors the system and amount of the annual remuneration for Board members, as well as the individual remuneration of the Executive Directors and the other terms of their contracts, pursuant in all cases to the provisions of the Company´s Bylaws.

b) To report to the Board of Directors on the contractual terms on termination for the Senior Executives, including Executive Directors, and to ensure that any payments made are fair to the individual and the Company, that failure is not rewarded and the duty to mitigate loss is fully recognised.

c) To report to the Board of Directors on the Senior Executive remuneration policy and the basic terms of their contracts.

d) To report on incentive plans and pension arrangements.

e) To periodically review the remuneration programs, taking into account their suitability and performance and how they reflect and support the Company strategy.

f) To give due regard to the provisions of applicable good governance codes, applicable law or regulation and requirements imposed by any stock exchange on which the Company's securities are listed when determining any compensation packages and arrangements.

g) To ensure that the disclosure requirements of the United Kingdom Listing Rules, any other applicable listing rules, applicable law or regulation and relevant stock exchanges are fulfilled, including the report on directors' remuneration required to be included in the Company's annual report and accounts.

Beyond Executive Directors, the Committee oversees the general application of the remuneration policy to the IAG Management Committee, and also remuneration matters of senior managers generally across the IAG Group.

According to article 25 of the Board Regulations, the Committee shall be made up of no less than three and no more than five Non-Executive Directors appointed by the Board, with the dedication, capacity and experience necessary to carry out their function. At least two of the members of the Committee shall be Independent Directors.

During 2014, the members of the Committee were Baroness Kingsmill (Chair), Dame Marjorie Scardino, Alberto Terol and, since October 30, 2014, María Fernanda Mejía. For the reporting period all members were considered Independent Non-Executive Directors of the Company and none of the members has any personal financial interest, other than as a shareholder, in the matters to be decided.

In February 2014, the Committee appointed Towers Watson as its external advisers. The decision to appoint Towers Watson was made by the Committee following a tender process. Towers Watson report directly to the Committee. The fees paid to Towers Watson for advice provided to the Committee were €65,487 for 2014.

The Company obtained high-level headline remuneration survey data from a variety of sources. During the year, the CEO of IAG provided regular briefings to the Committee apart from when his own remuneration was being discussed.

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Madrid, April 28, 2015.