



PIRELLI & C. S.p.A. – Milan

# **0. REPORT ON CORPORATE GOVERNANCE AND STRUCTURE OF SHARE OWNERSHIP 2012**



# CONT

# ENTS

Y. ANNUAL FINANCIAL REPORT  
AT DECEMBER 31, 2012

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\* This volume is a specific, integral section of the Directors' Report on Operations.





# EXECUTIVE SUMMARY







An Executive Summary of the Report on Corporate Governance and the Structure of Share Ownership is provided below that contains a brief description of the operation of Pirelli's corporate governance. The reader is referred to the specific sections of the Report for further details.

## EXECUTIVE SUMMARY

The Company adopts the traditional system of administration and control.

Pirelli's Corporate Governance system is based on the following: (i) the central function of the Board of Directors, responsible for the strategic guidance and supervision of the Company's overall business activities, with policy-making powers in relation to the overall administration and the authority to intervene directly in a series of significant decisions necessary or useful to achieve the company purpose; (ii) the central role of Independent Directors who represent the majority of the members of the Board of Directors (iii) an effective internal control system; (iv) an innovative pro-active risk management system; (v) a remuneration system, in general, and an incentive system, in particular, for Managers associated with medium and long-term economic targets in order to align the management's interests with the shareholders' interests, by pursuing the priority objective of creating sustainable value in the medium-long term, by establishing a strong link between remuneration, on the one hand, the performance of individuals and Pirelli's performance, on the other hand; (vi) a strict discipline concerning potential conflicts of interest and solid principles of conduct to execute transactions with related parties.

Pirelli complies with the Self-Regulatory Code of companies listed on the Italian Stock Exchange (Borsa Italiana) from the date the Code was first issued (in October

1999 having then complied with the Code dated July 2002 and subsequently the Code dated March 2006).

Pirelli declared its compliance with the new version of the Self-Regulatory Code (December 2011) in the Board of Directors' meeting held on March 12, 2012, the Code is published on the following website: [www.borsaitaliana.it](http://www.borsaitaliana.it).

The governance system is formally defined in the Code of Ethics, in the Company Bylaws, in the Regulation that governs Shareholders' Meetings and in a series of principles and procedures which are updated periodically to assure best practices.

Pirelli has been declared the "Best Corporate Governance in Italy" for the third consecutive year in the framework of the World Finance Corporate Governance Award 2013.

Pirelli was the Key Sponsor of the ICGN International Corporate Governance Network) Annual Conference during 2012.

## BOARD OF DIRECTORS

The Board of Directors is responsible for the strategic guidance and supervision of the Company's overall business activities, with policy-making powers in relation to the overall administration and the authority to intervene directly in a series of significant decisions necessary or useful to achieve the company purpose.

Indeed, the Board of Directors is responsible for making the most important decisions in relation to economic/strategic aspects or in terms of the structural impact on operations or functional to exercising the control and policy-making activities.

When executing its activities, the Board of Directors avails itself of the support of special Board Committees which have fact-finding, proposing and/or advisory duties, as well as managerial committees comprising the senior management which implement the directives and the policies established by the Board of Directors and by the Executive Directors and collaborate with the latter to define the respective proposals to be submitted to the Board concerned. The Board of Directors is appointed by means of the "voting list" system, thereby assuring the so-called "minorities" the appointment of one fifth of the Board Members, if at least two lists are presented.

The Board of Directors in office at the Date of this Report comprises 18 Directors which fall from office with the Meeting convened to approve the Financial Statements for the year closed as of December 31, 2013.

By adopting the voting list system, the so-called minorities were able to appoint 4 Directors, corresponding to one fifth of the total.

The female presence on the Board of Directors corresponded to 20% after this appointment, and thereby complied immediately with the requirements envisaged by Law No. 120 dated July 12, 2011 that by amending the Articles of the Unified Finance Law (TUF) relating to the composition of administrative bodies (Article 147-ter) and control bodies (Article 148), established an obligation whereby company bodies shall include at least one fifth of the gender less represented (in the first application). The new provisions will be applicable starting from the first renewal of the administrative and control bodies one year after the date the law comes into force, therefore, in the case of the Pirelli Board of Directors starting from the Board's renewal envisaged with the meeting to approve the Financial Statements as of December 31, 2013.

## EXECUTIVE DIRECTORS

The Board appointed Marco Tronchetti Provera as Chairman and Managing Director in the meeting held on April 21, 2011. In particular, in an increasingly competitive and selective market in terms of product and a market that is expanding continuously from the geographical point of view, Pirelli has decided to enhance the technological and commercial presence associated with different business areas, by completing the redefinition of the organisation model initiated in October 2011 by shortening further the decision-making chain so as to streamline the implementation of the plans of action established by the Premium strategy. The new structure envisages replacing the Executive Office (established when the 2012-2014 Industri-

al Plan was launched) and the concurrent creation of two new roles reporting directly to the Chairman and Managing Director: the Chief Technical Officer (CTO) and the Chief Commercial Officer (CCO).

## INDEPENDENT DIRECTORS

The Board of Directors is characterised by a number of Independent Directors who represent the absolute majority of its members since 2006, with a more rigorous approach also concerning the Self-Regulatory Code that in the case of companies included in the FTSE-MIB index makes a recommendation that at least one third of the Board is to be composed of Independent Directors.

The Board of Directors identifies the independence of its Directors in terms of their freedom from relations with the Company and/or the Company's main shareholders and Executive Officers who may influence their opinion.

There are ten independent Board Members at the Date of the Report, while a further six Board Members can be qualified as "non-executive Directors".

Accordingly, the Independent Directors represent the majority of the Directors in office and approximately 2/3 compared to the total of the "non-executive Directors".

Pirelli deems that the central function of the Board of Directors is to define the strategic policy guidelines and to supervise the Company's business activities and in order to perform this important task effectively the presence of an adequate number of Independent Directors with high professional and personal skills and expertise on the Board of Directors and on the Committees, plays a central role. This is actually the case and, as has been said, the majority of the Board of Directors is composed of Independent Directors from 2006 and the Remuneration Committee and the Committee for Internal Control, Risks and Corporate Governance are composed only of Independent Directors since 2000. The significant representation of Independent Directors is also assured in the framework of the newly established Appointments and Succession Committee and the Strategies Committee; the latter comprises mainly of Independent Directors and its composition reflects the mix of expertise and the presence of executive, non-executive and Independent Directors of the Board of Directors.

Lastly, all the Independent Directors (including Directors elected from the so-called minorities) sit on at least one Committee.

## LEAD INDEPENDENT DIRECTOR

The Board of Directors decided to introduce the figure of the Lead Independent Director already from November 2005 in order to further enhance the role played by the Independent Directors.

The Lead Independent Director represents the reference and coordination point for the requests and contributions of the Independent Board Members and in this capacity:

- collaborates with the Chairman of the Board of Directors to achieve the best operation of the Board concerned;
- has the authority to convene meetings - also informal meetings - involving only the Independent Directors, independently, or at the request of other Board Members, in particular, concerning issues relating to the way the Board of Directors operates, and more in general, concerning the way the Corporate Governance System operates, also with the possibility of inviting members of the management for a discussion with the organisational structure;
- collaborates with the Chairman of the Board of Directors to assure that the Directors receive complete and timely information flows.

The Lead Independent Director has participated in all the Board of Directors' meetings and in all the meetings of the Committee for Internal Control and Corporate Governance, in the framework of the mandate up to the Date of the Report and, as in the past, the Lead Independent Director was constantly in contact with the Chairman of the Board of Directors also during the 2012 financial year precisely to facilitate a constant improvement of the Board reporting process.

The Lead Independent Director then organised three meetings during the 2012 financial year involving only the Independent

Directors to examine in greater detail matters relating to the Company's corporate governance system, confirming a special focus on such aspects.

## BOARD COMMITTEES

The Board established four committees after its renewal, on April 21, 2011, two of which were new committees: the Committee for Internal Control, Risks and Corporate Governance, the Remuneration Committee; the Appointments and Succession Committee and the Strategies Committee.

## APPOINTMENTS AND SUCCESSION COMMITTEE

The Appointments and Succession Committee is composed of 4 Board Members, the majority of whom are non-executive (2 Independent Directors). The Committee is composed of the following persons:

- Marco Tronchetti Provera (Chairman);
- Luigi Campiglio;
- Vittorio Malacalza;
- Luigi Roth.

When defining the responsibilities of the Appointments and Succession Committee the Board of Directors assessed the increasing importance for Pirelli and for the market of the Board's direct involvement in defining the succession policies (i) not only and not just in relation to possible natural changes of the Executive Directors, for which however, the decisions made by the shareholders assume a decisive role, but in general (ii) concerning the top and senior management to assure the necessary continuity of the management action.

The responsibilities attributed to the Committee are outlined in greater detail later in the Report.

## STRATEGIES COMMITTEE

The Strategies Committee is composed of 7 Board Members, the majority of whom are Independent Directors). The General Counsel also sits on the Strategies Committee. The Strategies Committee was composed of the following persons at the Date of the Report:

- Marco Tronchetti Provera (Chairman);
- Alberto Bombassei;
- Franco Bruni;
- Vittorio Malacalza;
- Renato Pagliaro;
- Carlo Secchi;
- Manuela Soffientini;
- Francesco Chiappetta;

The Committee has advisory and proposing functions when defining the strategic guidelines, as well as to identify and define the conditions and terms of individual transactions of strategic importance.

The tasks assigned to the Committee are outlined in greater detail later in the Report.

## REMUNERATION COMMITTEE

The Committee is composed of four members who are exclusively independent, based on the more rigorous approach recommended in the Self-Regulatory Code of the Italian Stock Exchange (Borsa Italiana) dated December 2011; however, the version of the Self-Regulatory Code dated 2006 (in force at the date the Committee in office was appointed) included a recommendation that the Remuneration Committee was only to be composed of non-executive Directors, of which “only” the majority were to be Independent Directors.

The Remuneration Committee is composed as follows at the Date of the Report:

- Carlo Acutis (Chairman);
- Anna Maria Artoni;
- Pietro Guindani;
- Luigi Roth.

The Committee has advisory, proposing and supervisory functions to assure the definition and implementation of remuneration policies within the Group which, on the one hand, are designed to attract, motivate and retain the resources which have the professional qualities required to achieve the Group’s objectives profitably, and on the other hand, are able to align the management’s interests with the shareholders’ interests.

The Committee’s specific responsibilities are outlined in detail later in the Report.

## GENERAL REMUNERATION POLICY

Pirelli defined a Remuneration Policy already from the 2011 financial year, one year early compared to the legal obligation, and submitted the policy to the advisory vote of the shareholders.

Pirelli’s objective in relation to the human resources policy is to attract, motivate and retain the resources with the professional qualities required to achieve the Group’s objectives profitably. The Remuneration Policy is structured to achieve this objective.

In fact, the Policy is defined so as to align the Management’s interest with the interests of the shareholders, pursuing the priority objective of creating sustainable value in the medium/long-term, by creating a strong link between the remuneration, on the one hand, and individual performance and Group performance on the other hand.

The definition of the policy is the result of a clear and transparent process in which the Remuneration Committee and the Board of Directors play a central role.

## COMMITTEE FOR INTERNAL CONTROL, RISKS AND CORPORATE GOVERNANCE

The Committee has advisory and proposing functions and has the mission, on the one hand, of assuring the efficiency, effectiveness and correctness of the internal control system and the corporate governance structure, in general, on the other hand, based on a detailed preliminary activity concerning the risk management system,.

The Committee is composed of four members, who are exclusively independent based on the more rigorous approach recommended in the Self-Regulatory Code of the Italian Stock Exchange (Borsa Italiana) dated December 2011; however, the 2006 version of the Self-Regulatory



Code, (in force at the date the Committee in office was appointed) included a recommendation that this Committee should only be composed of non-executive Directors, in which “only” the majority were to be Independent Directors.

Prof. Paolo Ferro-Luzzi died on 11<sup>th</sup> November 2012 and was a member of the Committee for Internal Control, Risks and Corporate Governance; therefore, the Committee was composed of the following members at the Date of the Report:

- Carlo Secchi (Chairman);
- Franco Bruni;
- Elisabetta Magistretti;
- Luigi Roth.

On April 21, 2011 the Board of Directors confirmed the responsibilities originally assigned to the Committee for Internal Control and Corporate Governance, moreover, in line with the responsibilities set out in the Self-Regulatory Code, and also confirmed the prerogatives concerning corporate governance which characterise the Committee from the date it was established.

The tasks assigned to the Committee for Internal Control, Risks and Corporate Governance are outlined in detail later in the Report.

## MANAGERIAL COMMITTEES

Specific managerial committees are established within the Group comprising top and senior management with the responsibility of assisting the Board of Directors and the Executive Directors in defining the Company's business guidelines and to implement the policies established by the Board.

In particular, the following principal Managerial Committees were established, among others, and their respective tasks are described in greater detail later:

- Management Committee;
- Risk Management Committees;
- Sustainability Steering Committee;

- Product Committees;
- Business Unit and Region Performance Reviews;
- Organisation and People Review Committee.

## SUCCESSION PLANS

First of all, the Appointments and Succession Committee examined the corporate processes relating to the identification, management and development of “talents” which assure the Group has a “natural source” of in-house growth over time, thereby ensuring a constant generational change. The Committee also examined the main initiatives implemented to assure the development of management responsibilities and the process to define the so-called “succession tables”.

Accordingly, the Committee was able to verify the structure and the implementation status of the systems which enable Pirelli (i) to monitor the key resources present and to verify the existence of any in-house persons capable of assuming more responsible roles or (ii) to define the skills and expertise required to fill these roles in the case of recruiting from outside in the event of “emergency” changes. The Appointments and Succession Committee then appointed a specialised company forming part of a global network to support Pirelli in defining the top and senior management succession plans.

Based on the outcome of the analyses performed the Committee (i) prepared a proposal for a structured succession plan for the Company's top management to be implemented in the case of urgency; the plan envisaged the roles and responsibilities of the various players involved in the process defined and (ii) prepared a proposal of the process to be followed to define the natural succession plan for the Company's top management.

It is foreseen that the Board of Directors will examine the Committee's proposals during 2013 and adopt the succession plan for the Company's top management to be implemented in the case of urgency and approve the process to be followed to define the natural succession plan of the Company's top management.

## INTERNAL CONTROL SYSTEM

In general, Pirelli's internal control system is structured to assure correct information and adequate control of all the Group's activities, with particular attention paid to the areas deemed to represent a potential risk.

The internal control system within Pirelli is primarily a "management" tool; since, on the one hand, part of the Directors' responsibilities is to prepare the organisation and to ensure the organisation is adequate; on the other hand, because the Directors have full and complete visibility over the organisation concerned, via the internal control system, and are able to intervene accordingly.

In particular, the internal control system permits compliance with the rules and procedures which govern the performance of the business activities in their various forms to be monitored.

The Pirelli internal control system developed as a direct process to achieve the values of substantial and procedural fairness, transparency and accountability, assuring: efficiency, transparency and traceability of the transactions and, more in general, the management related activities; the dependability of the accounting and management data and the financial information; compliance with the laws and regulations; protecting the Company's integrity, also for the purpose of preventing fraud to the detriment of the Company and the financial markets.

The Company's "internal control system" also means "constructing" an organisational structure consistent with the dimensions, nature and complexity of the business activity performed, as well as with its geographical location, and this aspect is considered in terms of both the definition of the roles and responsibilities and (consequently) the conferral of the

so-called powers of "representation". The responsibilities within Pirelli are defined, on the one hand, to avoid functional overlapping and, on the other hand, critical activities being concentrated with a single person.

## THE RISK GOVERNANCE SYSTEM

In July 2009, the Board of Directors approved a new model for the assessment and governance of risks liable to prejudice the achievement of Pirelli's strategic objectives.

The Board deemed it appropriate to adopt a structured process for risk management in the Company in view of the accelerating pace of economic changes, the complexity of the management activities and recent regulatory developments in terms of corporate governance and internal control. The risk management process, on the one hand, permits the risks to be identified promptly and completely and, on the other hand, to adopt appropriate measures to "manage" the risks in terms of anticipating the risks and taking pro-active measures, rather than simply taking reactive measures.

In particular, the Board evaluated the importance of identifying both the risks before they manifest themselves and the adoption of business choices and appropriate tools to prevent them, reduce their impact, and more in general, to "manage them", without prejudice to the fact that the assumption of risk represents an essential component of the Company's business activity.

In accordance with this philosophy, the new integrated risk governance model (Enterprise Risk Management) has the following aims:

- "to manage" risks in terms of prevention and mitigation;
- "to seize" the opportunity factors proactively;
- to disseminate the "culture" of the value at risk within the company, in particular, in the strategic planning and operational processes and in the most important corporate decisions;
- to assure transparency in terms of the risk assumed and the management strategies implemented, based on periodic and structured reporting to the Board of Directors and to the Top Management and adequate information to the shareholders, and more in general, to all the so-called stakeholders.

It is important to observe the central role played by the Board of Directors with reference to the governance of the new model, since the Board of Directors is responsi-

ble for supervising the risk management process so that the risks assumed in the framework of the Company's business activities are consistent with the strategies (so-called monitoring action). Moreover, the Board defines the attitude to risk (so-called identification of the "acceptable risk threshold") and establishes the guidelines to manage the risks which can "interfere" with or prejudice achieving the company purposes or erode critical corporate assets, in line with its top management and strategic policy making mission.

The Risk Model was reviewed during 2012 and three risk macro families were identified which guide the risk management objectives: (i) Risks associated with the external environment; (ii) Strategic Risks; (iii) Operational Risks.

The Board of Directors is supported by two Risk Management Committees in relation to the different risk macro families, each Committee has specific areas of responsibility.

## CODE OF ETHICS – POLICY GUIDELINES

The Code of Ethics outlines the general principles adopted as a reference for the performance and conduction of business within Pirelli; the Code of Ethics indicates the aims and values underlying the Company's business activities. Indeed, Pirelli states that its internal and external business is based on complying with the Code of Ethics, in the belief that business success cannot be separated from ethics in business.

The Policy Guidelines contain an "operative" statement of the principles contained in the Code of Ethics and establish rules, for the whole Group, designed to prevent the creation of an environment favourable to committing offences in general.

The Code of Ethics and the Policy Guidelines are translated into all the languages

used within the Pirelli Group (22 different languages).

## THE SUPERVISORY BODY

A special Supervisory Body supervises the functioning and compliance with the Organisational Model 231 adopted by the Company, the Supervisory Body is economically independent and is composed of the Board Member Carlo Secchi, Lead Independent Director and the Chairman of the Committee for Internal Control, Risks and Corporate Governance, by the Statutory Auditor Antonella Carù and by Maurizio Bonzi, the Internal Audit Function Manager.

## AUDIT COMPANY

The statutory audit activities are performed by a company appointed by the Shareholders' Meeting from among the registered companies. Reconta Ernst & Young S.p.A. was conferred the mandate to audit the financial statements, the consolidated financial statements and the abridged interim financial statements referred to the 2008 – 2016 financial years.

## OFFICER RESPONSIBLE FOR PREPARING THE COMPANY'S ACCOUNTING DOCUMENTS

The Board of Directors, with the favourable opinion expressed by the Board of Statutory Auditors, confirmed Francesco Tanzi, Administrative and Finance Executive Manager as the Responsible Officer in the meeting held on April 21, 2011, the Responsible Officer is also responsible for the Group's Financial Statements and Taxes functions.

## INTERESTS OF DIRECTORS AND TRANSACTIONS WITH RELATED PARTIES

The Company established principles of conduct to execute transactions with related parties from 2002, these principles are designed to assure an effective substantial and procedural correctness and transparency in the transactions of this nature undertaken by the Company directly or through subsidiaries.

Following Consob's adoption of a special Regulation to govern transactions with related parties in March 2010, the Company subsequently approved a specific and structured

procedure (on November 3, 2010) concerning transactions with related parties.

The procedural decisions adopted by the Company are more rigorous compared to the requirements envisaged by the Regulations.

For example: Pirelli adopted very restrictive exiguity thresholds and established more significant qualitative thresholds not prescribed by the Consob Regulation. In particular, Pirelli has envisaged a significantly reduced exiguity threshold (150 thousand euro) compared to the threshold commonly adopted by other listed companies (that as a consequence exempts the procedure being applied to the transaction) and a “qualitative” threshold that establishes the classification of a given transaction as being of “greater importance” (for which, the Board of Directors’ prior approval is required, in addition to the favourable opinion expressed by the Independent Directors), irrespective of its value (even if below the thresholds established by the Procedure) when the transaction concerned, in terms of its nature, strategic importance, entity or commitments has a considerable impact on Pirelli’s business activities or may have an impact on its management autonomy.

Furthermore, the Procedure established that the Committee’s opinion concerning the transactions with related parties is also binding in the case of less important transactions and has decided not to avail itself of the so-called whitewash mechanism in the case of an unfavourable opinion when concerning more important transactions with related parties.

The transactions undertaken independently by subsidiaries with the Company’s related parties and not only the transactions undertaken “through” the subsidiaries concerned are also to be submitted to the Procedure, with an expectation, also in this case, that is significantly more rig-

orous compared to the Regulation.

The Company has envisaged that the Committee called to express its opinion on the transactions with related parties shall always be composed exclusively of Independent Directors, thereby confirming the importance the Company attributes to the role played by the Independent Directors (and not only in the case the Committee examines transactions with related parties of greater importance, as envisaged by the Regulation). Accordingly, the mandatory favourable opinion to be expressed by the competent Committee is envisaged also in this case, thereby adopting a more rigorous approach compared to the Consob Regulation for all the transactions with related parties (therefore, also the transactions of “lesser importance” and not only the transactions of “greater importance” as prescribed by Consob).

The Company has also envisaged adopting a remuneration policy to allocate the remuneration to Directors and Executive Managers with strategic business responsibilities, including policies relating to agreements for consensual termination of the relationship that enables these decisions to be exempt from the ordinary procedure provided that (i) a Committee composed exclusively of non-executive Directors, the majority of whom were Independent Directors was involved when defining the remuneration policy (in this regard, the reader is referred to the “Remuneration Committee” section); (ii) the policy was submitted to the advisory vote of the Shareholders’ Meeting; (iii) the remuneration assigned is consistent with this policy.

Lastly, the Company has adopted the Consob recommendation to envisage a review of the Procedure at least every three years.

The Board has deemed that the Board Committees established within the Board of Directors meet the characteristics and requirements envisaged by the Consob Regulations and those established by the Procedure examined by the Board and accordingly has assigned the foreseen responsibilities of the Committee for Transactions with related parties to the Committee for Internal Control, Risks and Corporate Governance, in accordance with the cited procedure, with the sole exception of the responsibilities concerning the remuneration of Directors and Executive Managers with strategic business responsibilities attributed to the Remuneration Committee.

## BOARD OF STATUTORY AUDITORS

The Board of Statutory Auditors is entrusted with the responsibility of supervising the following aspects, as provided for by law and the Company Bylaws:

- compliance with the law and the Company Bylaws;
- respecting the principles of sound administration;
- the adequacy of the Company's organizational structure considering the aspects within its area of responsibility, the internal control system and the administration and accounting system, as well as the dependability of the latter to represent correctly management-related issues;
- the procedures to actually implement the corporate governance rules envisaged in the codes of conduct drawn up by the companies which manage regulated markets or by trade associations, which the Company declares to comply with;
- the adequacy of the instructions issued by the Company to its subsidiaries concerning the obligations of disclosing price sensitive information;
- the financial reporting process; the efficiency of the internal control system, the internal audit system and the risk management system; statutory audit of the annual accounts and the consolidated accounts; the independence of the statutory auditor or the statutory audit company, in particular, with regard to providing services other than auditing to the company subjected to the statutory audit of the accounts.

When performing its functions the Board of Statutory Auditors takes part in the work performed by the Remuneration Committee and the Committee for Internal Control, Risks and Corporate Gov-

ernance, in addition to participating in all the Board of Directors' meetings and the Shareholders' Meetings. Furthermore, Antonella Carù, a Statutory Auditor was invited to become a member of the Supervisory Body, in accordance with Legislative Decree No. 231/2001.

The Company Bylaws envisage that the Board of Statutory Auditors is to be composed of the three Statutory Auditors and two Alternate Auditors.

The appointment is envisaged to be made by means of the so-called "voting list" system, in accordance with which one Statutory Auditor and one Alternate Auditor are selected from the list that obtained the highest number of votes after the first (so-called minority list).

The Chairman of the Board of Statutory Auditors is assigned to the Statutory Auditor indicated as the first candidate in the minority list, if presented.

The Shareholders' Meeting held on May 10, 2012 appointed the Board of Statutory Auditors for the 2012 - 2014 financial years, using the voting list system, by appointing Francesco Fallacara (appointed as Chairman, since drawn from the list presented by minorities); Antonella Carù and Enrico Laghi, as Statutory Auditors and appointing Umile Sebastiano Iacovino and Andrea Lorenzatti (drawn from the minority list) as Alternate Auditors.

## RELATIONS WITH SHAREHOLDERS

In its tradition of transparency the Company manages with special attention the relations with Shareholders, with Investors (institutional and private investors), with financial analysts, with other market players and with the financial community in general, in compliance with their reciprocal roles and by promoting periodic meetings in Italy and abroad.

Moreover, the Investor Relations Management function was established from March 1999 in order to favour an ongoing dialogue with the financial market and was entrusted to Ms. Valeria Leone from October 2008.

The Pirelli Internet website dedicates a section called Investors designed to establish an open, immediate and transparent dialogue with all parties requiring financial information concerning Pirelli; the Investors section includes the details required for an initial contact with Pirelli for evaluation purposes.

Furthermore, Pirelli has prepared a section on the website dedicated to Retail investors in the case of individual

investors.

Investor Relations has an e-mail address (ir@pirelli.com) to facilitate the dialogue with the Company.

The Company confirmed its attention in relation to “Ethical investors” during 2012 by participating in international conferences concerning governance and sustainability.

Company’s Board of Directors whenever deemed appropriate or whenever the call is requested, as required by law.

The savings Shareholders’ Meeting that was held on January 31, 2012 appointed prof. Giuseppe Niccolini, lawyer as the Common Representative for the 2012-2014 financial years.

## SHAREHOLDERS’ MEETINGS

The discipline that governs the operation of the Shareholders’ Meetings has been profoundly innovated following the provisions introduced into Italian legislation by Legislative Decree No. 27 of 2010 that adopted Directive 2007/36/EC in the legal system, designed to facilitate the participation by shareholders of listed companies in Shareholders’ Meetings.

The operation of the Shareholders’ Meetings is governed by the Shareholders’ Meetings Regulation duly approved by the Shareholders’ Meeting held on May 11, 2004 and subsequently amended by the Shareholders’ Meeting held on April 23, 2007, in addition to the law and the Company Bylaws.

Following the changes introduced by Legislative Degree No. 27/2010 that introduced into Italian legislation the so-called record date mechanism, the shareholders entitled to attend Shareholders’ Meetings and entitled to cast their vote are those shareholders who are entitled to attend the meeting and cast their vote at the close of the accounting day on the seventh trading day prior to the date set for the single call. The records of credits and debits performed on accounts after this deadline will not influence the entitlement to vote at the Shareholders’ Meeting.

With regard to the shareholders’ meeting of the holders of savings shares this meeting is called by the Company’s Common Representative of savings shareholders or by the

# GLOSSARY

## **SHAREHOLDERS' MEETING TO APPROVE THE FINANCIAL STATEMENTS FOR 2012:**

means the Shareholders' Meeting convened to approve the Financial Statements as of December 31, 2012;

## **C.C.:**

indicates the Italian Civil Code;

## **SELF-REGULATORY CODE:**

indicates the Self-Regulatory Code of Conduct for listed companies approved by the Corporate Governance Committee and promoted by Borsa Italiana S.p.A. with which the Company complies and is published on the following website: [www.borsaitaliana.it](http://www.borsaitaliana.it);

## **BOARD OR BOARD OF DIRECTORS:**

indicates the Board of Directors of Pirelli & C.;

## **CONSOB:**

indicates the National companies and stock exchange commission;

## **DATE OF THE REPORT:**

indicates the Board of Directors' Meeting held on March 12, 2013 that approved this report;

## **RESPONSIBLE OFFICER:**

means the Executive Manager responsible for preparing the company's accounting documents, as set out under Article 154-bis of the Unified Finance Law (TUF);

## **2012 FINANCIAL YEAR:**

indicates the financial year closed as of December 31, 2012;

## **PIRELLI:**

indicates the group of which Pirelli & C. is the Parent Company;

## **PIRELLI & C.:**

indicates Pirelli & C. S.p.A. with registered office in Milan, Tax Code, VAT registration and registration number in the Milan Register of Companies under No. 00860340157;

## **PIRELLI TYRE:**

indicates Pirelli Tyre S.p.A. with registered office in Milan, Tax Code and registration number in the Milan Register of Companies under No. 07211330159;

## **ISSUER REGULATIONS:**

indicates the Regulations issued by Consob with resolution No. 11971 of 1999 relating to issuers and the subsequent amendments and supplements;

## **MARKET REGULATIONS:**

indicates the Regulations issued by Consob with resolution No. 16191 of 2007 relating to markets and the subsequent amendments and supplements;

## **REPORT:**

indicates this report on corporate governance and the structure of share ownership prepared in accordance with Article 123-bis of the Unified Finance Law (TUF);

## **PIRELLI INTERNET WEBSITE:**

the institutional Pirelli website containing, inter alia, information relating to the Company and reachable at the Internet domain: [www.pirelli.com](http://www.pirelli.com);

## **COMPANY:**

indicates Pirelli & C.;

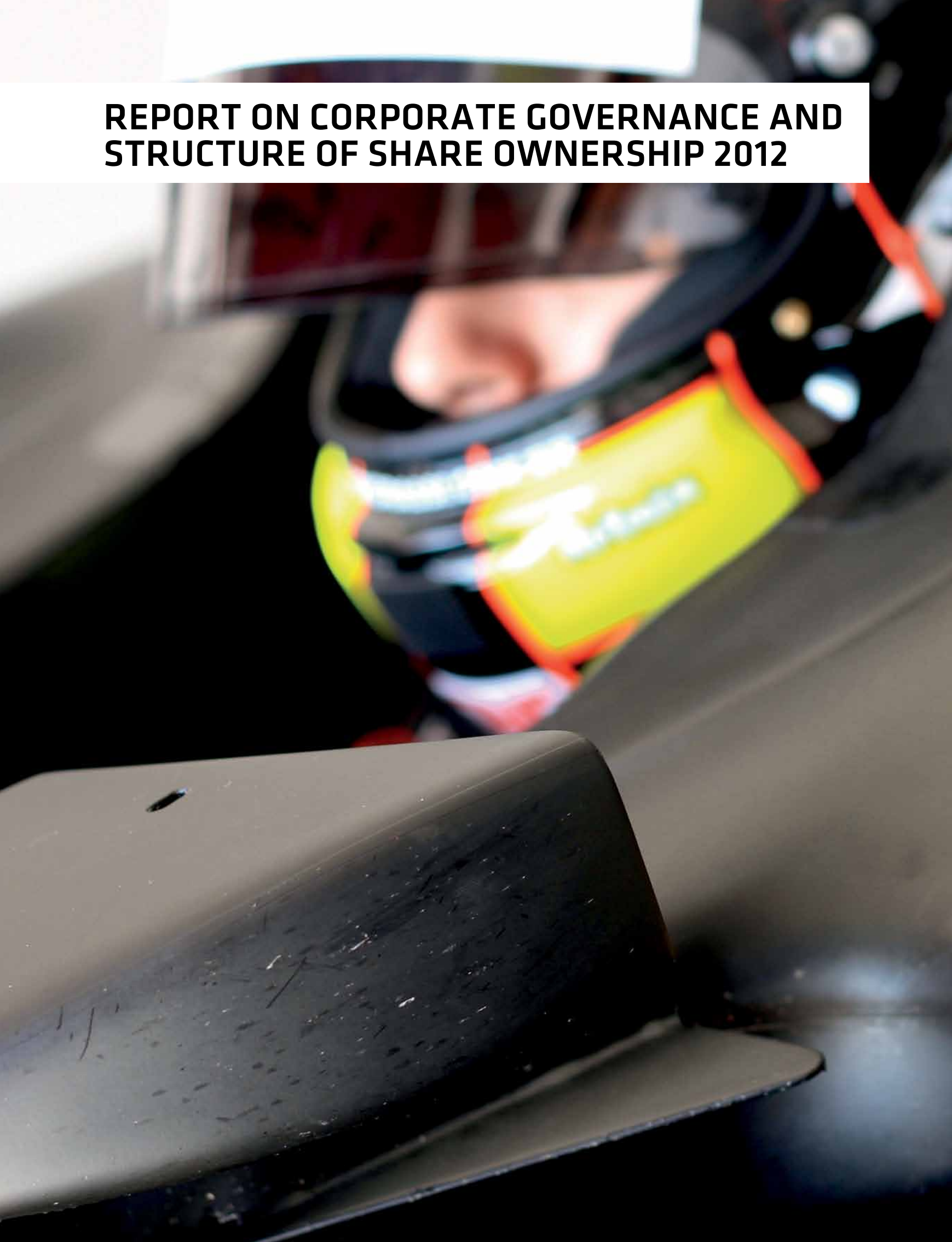
## **COMPANY BYLAWS:**

indicates the Company Bylaws of Pirelli & C., available on the Pirelli Internet website;

## **UNIFIED FINANCE LAW (TUF):**

indicates Legislative Decree No. 58 dated February 24, 1998, (Unified Finance Law).

# REPORT ON CORPORATE GOVERNANCE AND STRUCTURE OF SHARE OWNERSHIP 2012





**P ZERO™**

# REPORT ON CORPORATE GOVERNANCE AND STRUCTURE OF SHARE OWNERSHIP 2012

## 1. PROFILE OF THE COMPANY ISSUING THE REPORT

Pirelli & C. is the joint-stock company listed on the Italian Stock Exchange (Borsa Italiana) and is the Parent Company of the multinational group specialising in the tyre sector, and a leading company in the top of the range and high technological content segments.

The company was founded in 1872, and today Pirelli has production facilities in four continents and operates in more than 160 countries worldwide.

Pirelli stands out for its long industrial tradition that has always been combined with a capacity for innovation, product quality and a strong brand. This strength has also been supported from 2002 by the fashion and high-tech project of PZero and today further enhanced by the Formula 1, for which Pirelli is the exclusive supplier.

Pirelli has always focused on research and development in line with its green performance strategy and works with constant and growing attention paid to products and services of high quality and technology and a low environmental impact.

The awareness that an efficient corporate governance system represents one of the essential factors to achieve the objectives of creating sustainable value drives Pirelli to maintain its corporate governance system constantly in line with national and international best practices.

The Company adopts the traditional system of administration and control.

Pirelli's Corporate Governance system is based on the following factors: (i) the central function played by the Board of Directors that is responsible for the strategic guidance and supervising the Company's overall business activities, with a policy-making powers in relation to the overall administration and the authority to inter-

vene directly in a series of significant decisions necessary or useful to achieve the company purpose; (ii) the central role of Independent Directors who represent the majority of the members of the Board of Directors (iii) an effective internal control system; (iv) an innovative pro-active risk management system; (v) a remuneration system, in general, and an incentive system, in particular, for Managers associated with medium and long-term economic objectives in order to align the management's interests with the shareholders' interests, by pursuing the priority objective of creating sustainable value in the medium/long term, by establishing a strong link between remuneration, on the one hand, the performance of individuals and Pirelli's performance, on the other hand; (vi) a strict discipline concerning potential conflicts of interest and solid principles of conduct to execute transactions with related parties.

The governance system is formally defined in the Code of Ethics, in the Company Bylaws, in the Regulations concerning Shareholders' Meetings and in a series of principles and procedures which are periodically updated to assure best practices.

It is important to confirm that in the interim financial report Pirelli highlights the updates and integrations made to its corporate governance system compared to the information contained in the annual report.

Pirelli was declared the "Best Corporate Governance in Italy" for the third consecutive year in the framework of the World Finance Corporate Governance Award 2012.

Pirelli was the key sponsor of the ICGN (International Corporate Governance Network) Annual Conference during 2012

## 2. INFORMATION ON THE STRUCTURE OF SHARE OWNERSHIP (IN ACCORDANCE WITH ARTICLE 123-BIS, PARAGRAPH 1 OF THE UNIFIED FINANCE LAW (TUF)) AS OF MARCH 11, 2013.

### A) STRUCTURE OF THE SHARE CAPITAL.

The subscribed and paid-in share capital amounts to euro 1,345,380,534.66, divided into a total of 487,991,493 shares without par value indicated, of which 475,740,182 (euro 1,311,603,971.79) are ordinary shares and 12,251,311 (euro 33,776,562.87) are savings shares.

### *Rights and obligations.*

The shares are divided into ordinary shares and savings shares, without par value.

The ordinary shares entitle the holder to one vote per share; they are registered shares or bearer shares to the extent permitted by law, and in this case, can be converted from one type of share to the other type of share at the holder's request and expense.

Savings shares do not have voting rights and are bearer shares, unless otherwise provided for by law, and can be converted into registered savings shares at the shareholder's request and expense.

In addition to the rights and privileges envisaged by law and by the Company By-laws, savings shares have the right of first refusal in the reimbursement of capital up to the amount of euro 3.19 per share. If the share capital is reduced due to losses, the reduction does not affect the savings shares, except for the part of the loss that exceeds the portion of capital represented by the other shares.

Savings shares retain the rights and privileges set forth by law and by the Company Bylaws, even if the ordinary shares and savings shares are excluded from trading. If the share capital is increased by issuing shares of a single category, these shares must be offered as an option to all categories of shareholders.

If the share capital is increased by issuing ordinary and savings shares:

- holders of ordinary shares are entitled to receive options for ordinary shares and savings shares for any possible difference;
- holders of savings shares are entitled to receive options for savings shares and ordinary shares for any possible difference.

The net annual profit is divided as follows, after the legal allocation to reserve has

**PIRELLI WAS DECLARED THE  
“BEST CORPORATE  
GOVERNANCE IN ITALY” FOR THE THIRD  
CONSECUTIVE YEAR IN THE  
FRAMEWORK OF  
THE WORLD FINANCE CORPORATE  
GOVERNANCE AWARD 2012.**

been made:

- savings shares are attributed an amount up to 7% of euro 3.19; if the savings shares are assigned a dividend of less than 7% of euro 3.19 in a given financial year, the difference is added to the preference share dividend in the two following financial years; the profit that remains after the dividend specified above has been assigned to the savings shares is apportioned among all the shares so that the savings shares receive a dividend that is 2% of euro 3.19 higher, overall, compared to the dividend received by the ordinary shares;
- ordinary shares are attributed an amount of up to 5% of their par value in accounting terms (defined as the ratio between the amount of the share capital and the overall number of shares issued), without prejudice to the above provisions concerning the overall increased dividend payable to savings shares.

The remaining profit will be distributed among all the shares, in addition to the sums assigned as outlined above, unless the Shareholders' Meeting resolves special allocations to extraordinary reserves or for other uses, or decides to carry forward part of the foregoing portion of profit.

Savings shares have the same rights as the other shares if reserves are distributed.

Advances on dividends may be distributed as provided for by law.

*Financial instruments which attribute the right to subscribe to new issue shares.*

No financial instruments which attribute the right to subscribe to new issue shares were issued at the Date of the Report.

*Stock incentive plans.*

The Company does not currently have stock incentive plans.

The Shareholders' Meeting held on May 10 2012 adopted a three-year cash incentive plan (2012-2014 Long-Term Incentive) for the Pirelli Group Management (so-called LTI Plan). The LTI Plan envisages, inter alia, that part of the incentive is determined on the basis of a Total Shareholder Return objective - calculated periodically by the FTSE and included in the Borsa Italiana database, as well as in relation to an index composed by selected peers of the Tyres sector.

Further details are provided in the information document prepared, in accordance with Article 84-bis of the Issuers Regulation and in the Remuneration Policy referred to the 2012 financial year and both are available on the Pirelli Internet website in the governance section.

**B) RESTRICTIONS ON THE TRANSFER OF SECURITIES.**

There are no restrictions on the transfer of securities.

**C) SIGNIFICANT SHAREHOLDINGS.**

The parties owning shares with voting rights in the Ordinary Shareholders' Meeting, and representing more than 2% of the ordinary capital, according to the requirements published by Consob, are listed in Table 2.

**THE SHAREHOLDERS' MEETING HELD ON MAY 10 2012 ADOPTED A THREE-YEAR CASH INCENTIVE PLAN (2012-2014 LONG-TERM INCENTIVE) FOR THE PIRELLI GROUP MANAGEMENT (SO-CALLED LTI PLAN).**

**D) SECURITIES WHICH CONFER SPECIAL RIGHTS.**

There are no securities which confer special rights of control.

**E) EMPLOYEE SHAREHOLDINGS: MECHANISM TO EXERCISE VOTING RIGHTS.**

There are no mechanisms to exercise voting rights in the case of employee shareholdings, when such voting rights are not exercised directly by the employees concerned.

**F) RESTRICTIONS ON VOTING RIGHTS.**

There are no restrictions on voting rights (such as, for example: limitations on voting rights at a given percentage or at a certain number of votes, time limits imposed to exercise the voting rights or systems in which, with the Company's co-operation, the financial rights associated with the securities are separate from ownership of the securities).

**G) SHAREHOLDER AGREEMENTS.**

The list of participants in the "Sindacato Blocco Azioni Pirelli & C. S.p.A." (Pirelli & C. S.p.A. Shareholders' Agreement) (hereinafter, the "Agreement") aimed at assuring the stability of the shareholding structure of Pirelli & C., and an abstract from the text of the Agreement are included in the annex to the Report and can be accessed on the Pirelli Internet website.

In particular, it is important to observe that the agreement among the participants of the Shareholders' Agreement does not represent a controlling, or voting agreement.

Indeed, the shareholders' agreement management<sup>1</sup> meets to examine the proposals to be submitted to the Shareholders' Meeting, concerning the agreement's possible early termination and to accept new participants; moreover, the management meets at least twice a year to examine the interim trend, the annual results, the Company's general lines of development, the significant investment and divestment policy and, more in general, all matters within the jurisdiction of the ordinary and extraordinary Shareholders' Meeting.

The shareholders' agreement management resolves with the favourable vote of the members representing the majority of the shares conferred and when the resolutions of the shareholders' agreement management are not passed unanimously, the dissenting participant shall have the right to cast its vote freely in the Shareholders' Meetings.

#### **H) AMENDMENTS TO COMPANY BYLAWS.**

The amendments to the Company Bylaws are resolved as provided for by law.

#### **I) REGULATIONS APPLICABLE TO THE APPOINTMENT AND SUBSTITUTION OF DIRECTORS AND THE BOARD OF AUDITORS.**

In this regard, the reader is referred to the Board of Directors Section and the Board of Auditors Section.

#### **L) CHANGE OF CONTROL CLAUSES AND STATUTORY PROVISIONS CONCERNING A PUBLIC PURCHASE OFFER.**

**Change of control clauses.**

There is no party that can exercise control over Pirelli & C., either directly or indirect-

ly, also by virtue of shareholder agreements, individually or jointly with other subjects included in these agreements. It follows that no change of control of the Company can be envisaged at present.

The bond loan amounting to 500 million euro placed on the market by Pirelli & C. envisages that the bondholders are entitled to avail of the clause to request early repayment if a "Change of Material Shareholding" occurs that corresponds to the following cases: (i) Pirelli & C. no longer holds (directly or indirectly) a percentage of at least 85% of the share capital of Pirelli Tyre (barring the case that Pirelli Tyre is not incorporated in or does not incorporate Pirelli & C. or in another company of the Pirelli Group); (ii) a party other than one or more of the shareholders participating in the Pirelli Shareholders' Agreement (provided Camfin S.p.A. continues to participate as the first shareholder of Pirelli & C. among the participants) holds more than 50% of the share capital of Pirelli & C. with voting rights or acquires the right to appoint or remove the majority of the members of the Board of Directors; (iii) Camfin S.p.A. no longer holds (directly or indirectly) at least 20% of the share capital of Pirelli & C. with voting rights.

A similar clause is envisaged, except for the provision indicated in point (iii) above: (a) in the agreement entered into among Pirelli & C., Pirelli Tyre and Pirelli International Ltd. and a pool of lending banks in relation to granting Pirelli a revolving line of credit amounting to 1.2 billion euro; (b) in the bond loan issued by Pirelli International Limited on the American market for an overall value of 150 million American dollars and guaranteed by Pirelli Tyre; (c) in the "Schuldschein" loan obtained by Pirelli International Limited and guaranteed by Pirelli & C. and by Pirelli Tyre for 155 million euro overall.

**Statutory provisions concerning a public purchase offer.**

On a preliminary count, it is important to remember that Article 104 of the Unified Finance Law (TUF) envisages that Italian listed companies whose securities are subject to the offer shall refrain from executing actions or transactions

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<sup>1</sup> The Shareholders' Agreement management represents the agreement's body composed of the Chairman and the Deputy-Chairman who shall be the most senior Chairman and the Deputy Chairman in office of Pirelli & C., and by a member for each participant, without prejudice to the right of the participant that has contributed shares exceeding 10% of the share capital in ordinary shares to designate another member; for this purpose, if several companies associated by a control relationship have participated in the agreement or are controlled by the same Parent Company, the grouping, as a whole, will be considered in the same way as a single participant.

which may conflict with achieving the offer's objectives (so-called passivity rule), barring an authorisation by the Shareholders' Meeting. It is also envisaged that the companies' bylaws may derogate from the passivity rule foreseeing that the Board of Directors may adopt "defensive measures", even without an authorisation expressed in this sense by the Shareholders' Meeting. Furthermore, Article 104-bis of the Unified Finance Law (TUF) (recorded as the "Breakthrough rule") rules that the bylaws of Italian listed companies can foresee that when a public purchase offer or an exchange is promoted and involves the securities issued by them: (i) the restrictions on the transfer of securities envisaged in the Company Bylaws are not applicable in relation to the bidder during the offer acceptance period, nor are the restrictions on voting rights envisaged in the Company Bylaws or in the Shareholders' Agreements applicable in the Shareholders' Meetings convened to resolve the actions and transactions envisaged under Article 104 cited above; (ii) when the bidder, after an offer, holds at least 75% of the share capital with voting rights in resolutions concerning the appointment or revocation of Directors or Members of the Management Board or Supervisory Board, then the following conditions shall not apply in the first Shareholders' Meeting convened to amend the Company Bylaws or to revoke or appoint Directors or Members of the Management Board or Supervisory Board after closing the offer: the restrictions on voting rights envisaged in the Company Bylaws or in shareholders' agreements, nor any special right concerning the appointment or revocation of the Directors or Members of the Management Board or Supervisory Board envisaged in the Company Bylaws.

The Company Bylaws of Pirelli & C. do not envisage departures from the provisions concerning the passivity rule illustrated

previously or the application of the breakthrough rule contemplated under Article 104-bis.

#### **M) POWERS TO INCREASE THE SHARE CAPITAL AND AUTHORISATIONS TO PURCHASE TREASURY SHARES.**

**Powers to increase the share capital.**

Directors have not been given powers to increase the share capital against payment in one or more operations or given the authority to issue bonds convertible into both ordinary and saving shares or with warrants valid to subscribe to shares.

**Authorisations to purchase treasury shares.**

At the Date of the Report no resolutions had been passed by the Shareholders' Meeting which authorise the Board of Directors to plan to purchase treasury shares.

At the Date of the Report, the Company holds 351,590 ordinary treasury shares corresponding to around 0.07% of the category as well as of the whole share capital and 408,342 savings treasury shares corresponding to around 3.33% of the saving shares capital and corresponding to around 0.08% of the whole share capital.

In the meeting held on March 11, 2013 the Board of Directors resolved to submit to the approval of the Shareholders' Meeting convened to approve the 2012 financial statements the authorisation to purchase and dispose of (ordinary and savings) treasury shares - for a period of 18 months from the date on which the Shareholders' Meeting adopts the corresponding resolution - up to maximum number of (treasury) shares that do not exceed 10% of the share capital, also with regard to the treasury shares owned directly and indirectly by the Company (through subsidiary companies). For further information, the reader is referred to the Directors' Report to the Shareholders' Meeting to approve the 2012 financial statements.

#### **N) DIRECTORS' INDEMNITY IN THE CASE OF RESIGNATION, DISMISSAL OR TERMINATION OF THE EMPLOYMENT RELATIONSHIP FOLLOWING A PUBLIC PURCHASE OFFER<sup>2</sup>**

Pirelli has a policy not to enter into agreements with Di-

<sup>2</sup> The information contained in this section is provided also in compliance with the requirement set out in Consob Communication DEM/11012984 dated February 24, 2011.

rectors, Executive Managers with strategic business responsibilities, Senior Managers and Executives, which regulate beforehand economic aspects relating to the possible early termination of the employment relationship at the Company's initiative or at the individual's initiative (so-called "parachutes").

Indeed, the agreements entered into with Pirelli in the event the employment relationship is interrupted for reasons other than just cause do not represent "parachutes". Pirelli adopts a policy that seeks to come to agreements to reach a consensual conclusion of the employment relationship. In any event, the possible agreements reached to terminate the employment agreement with Pirelli relate to the reference benchmarks applicable in this area and fall within the limits defined by the jurisprudence and accepted practice of the country in which the agreement is made, without prejudice to legal and/or contractual obligations.

The Company defines internal criteria which are also complied with by the other Group companies when managing the agreements which discipline the early termination of relationships concerning Executives and/or Directors assigned special duties.

Pirelli does not envisage the payment of an extraordinary indemnity or compensation associated with the end of the mandate with regard to Directors assigned special duties in Pirelli & C. who are delegated with specific powers and are not bound by management level employment relationships.

The payment of a specific indemnity (that, accordingly, can be considered a "parachute") may be acknowledged, always subject to the assessment by the competent company bodies in the following cases:

- termination at the Company's initiative not supported by a just cause
- termination at the Directors' initiative for just cause, meaning, by way of ex-

ample, a substantial change of role, or of the powers assigned and/or the cases of a so-called "hostile" public purchase offer.

In these cases the indemnity - redefined by the Board of Directors during the 2013 financial year based on the Remuneration Committee's proposal - is equal to 2 annuities of the gross annual payment, meaning the sum of the fixed annual gross payments for the positions held in the Group; the average variable annual remuneration (MBO) accrued during the previous three year period; the End of Mandate Indemnity (TFM) on the foregoing amounts).

In this regard, the reader is referred to the "Remuneration Report" published on the Pirelli Internet website. It is important to note that the updated Remuneration Report referred to the 2013 financial year will be submitted to the Company's Shareholders' Meeting in the light of the new legislation and the applicable regulatory provisions governing the subject.

#### **O) MANAGEMENT AND COORDINATION ACTIVITIES (PURSUANT TO ARTICLE 2497 AND FOLLOWING ARTICLES OF THE ITALIAN CIVIL CODE).**

There is no party that can exercise control over Pirelli & C., directly or indirectly, also by virtue of shareholders' agreements, individually or jointly with the other parties participating in such agreements.

Nor is the Company subject to management and coordination activities by another company or body, pursuant to Article 2497 and following articles of the Italian Civil Code. By contrast, Pirelli & C., heads the Group of the same name and exercises management and coordination activities over numerous subsidiary companies and has disclosed the information envisaged under Article 2497-bis of the Italian Civil Code.

### **3. COMPLIANCE**

Pirelli complies with the Self-Regulatory Code for listed companies issued by the Italian Stock Exchange (Borsa Italiana) since the Code was first issued (in October 1999, having then complied with the July 2002 version and subsequently with the March 2006 version).

Pirelli declared its compliance with the new version of the Self-Regulatory Code (December 2011) in the Board Meet-

ing held on March 12, 2012, the new version is published on the following website: [www.borsaitaliana.it](http://www.borsaitaliana.it).

It is important to note that since Pirelli is one of the companies included on the FTSE-MIB index it is subject to the recommendations of the Self-Disciplinary Code envisaged specifically for such companies. The Report was also written on the basis of the experimental format distributed by the Italian Stock Exchange (Borsa Italiana) in February 2008, subsequently updated in February 2010 and in January 2013 and contains a specific section dedicated to the presentation of the risk management and internal control system in existence in relation to the financial disclosure process, as envisaged under Article 123-bis, paragraph 2, sub-section b) of the Unified Finance Law (TUF) and, with reference to the 2012 financial year.

Non-Italian statutory provisions which may influence the Company's corporate governance structure do not apply to Pirelli & C. at the Date of the Report.

#### 4. BOARD OF DIRECTORS

The Board of Directors is responsible for the strategic guidance and supervision of the Company's overall business activities, in line with the requirements relating to the traditional administration and control model and with the power to direct its overall administration and the power to intervene directly in a series of significant decisions necessary or useful to achieve the company purpose.

Indeed, the Board of Directors is empowered to assume the most important decisions in economic/strategic terms or in terms of the structural impact on operations, or functional to Pirelli exercising the control and policy-making activity.

When carrying out its duties, the Board of Directors avails of the support provided

## THE BOARD OF DIRECTORS IS RESPONSIBLE FOR THE STRATEGIC GUIDANCE AND SUPERVISION OF THE COMPANY'S OVERALL BUSINESS ACTIVITIES

by special Board Committees with fact-finding, proposing and/or advisory duties, as well as managerial committees composed of senior management which implement the directives and the policies established by the Board of Directors and by the Executive Directors (in this regard, the reader is referred to the "Managerial Committees" section) and collaborate with the latter to define the proposals to be submitted to the Board concerned.

The Board of Directors' meetings are attended by members of management, at the invitation of the Chairman and the Managing Director, to favour precise and in-depth knowledge of the business performed by the Company and by the Group on the part of the Directors and the Board of Directors as a whole, as well as to favour access to senior management to enhance the Board of Directors' ability to supervise the business activities<sup>3</sup>.

In particular, the participation of the Executives with strategic responsibilities (General Counsel and the General and Institutional Affairs Manager; the Planning and Control Manager, the Administration and Finance Manager and the Responsible Officer) in the Board of Directors' meetings, as well as the Chief Technical Officer, the Chief Commercial Officer, the Operations Manager and the Supply Chain Manager during the meetings convened to examine the periodic accounting positions and the quantitative objectives (annual budget and three-year Plan) is now a long-established practice.

Other members of management may be invited, from time to time, to participate in individual meetings to discuss specific topics on the Agenda.

<sup>3</sup> 2011 Self-Disciplinary Code: Application Criterion 1.C.6.



#### 4.1 APPOINTMENT AND REPLACEMENT OF DIRECTORS

Since 2004, the Company Bylaws<sup>4</sup> envisage that the Board is to be appointed based on the “voting list” system, thereby assuring that the so-called “minorities” can appoint one fifth of the Board Members if at least two lists are presented.

The lists presented by the shareholders, and duly signed by those presenting them, must be filed at the Company’s registered office, available to anyone who submits a request, at least 25 days prior to the date established for the Shareholders’ Meeting and are made available to the general public at the Company’s registered office, on the Pirelli Internet website and using the other methods envisaged by Consob at least 21 days prior to the date of the Shareholders’ Meeting.

Each shareholder may present or participate in the presentation of a single list and each candidate may be presented on only one list under penalty of ineligibility.

A proposal to restructure the shareholding quotas required by the Bylaws to present the lists was submitted to the Shareholders’ Meeting convened to approve the 2012 Financial Statements. In particular, the proposal entailed reducing the share capital quota (with voting rights in the ordinary shareholders’ meeting) to 1% (compared to the current 2%) required to present lists to appoint the Board of Directors, in any event, without prejudice to the smaller quota required by the regulatory discipline issued by Consob. In this regard, the reader is referred to the Directors’ Report to the Shareholders’ Meeting published on the Pirelli Internet website.

Therefore, if the Shareholders’ Meeting approves the proposal then shareholders who, alone or together with other shareholders, hold a total number of shares rep-

resenting 1% of the share capital entitled to vote in the ordinary shareholders’ meeting shall have the right to present lists, or the lower percentage required by the regulatory provisions issued by Consob (the percentage shareholding required for shareholders to present lists of candidates to be elected to the administration and audit bodies of Pirelli & C. was fixed at 1% of the share capital entitled to vote in the Ordinary Shareholders’ Meeting referred to the 2012 financial year)<sup>5</sup> subject to an obligation to demonstrate the ownership of the number of shares required to present the lists within the deadline envisaged for their publication by the Company (21 days prior to the meeting).

Declarations in which the individual candidates accept their candidacy and the declarations in which the individual candidates concerned attest that there are no causes for ineligibility and incompatibility, and that they satisfy the requirements for the respective offices, if prescribed, are to be deposited with each list. A curriculum vitae is to be registered for each candidate together with the declarations detailing the personal and professional characteristics and providing information concerning (i) the administration and control positions held with other companies and (ii) the eligibility to be qualified as independent, in accordance with the criteria established by law and the criteria adopted by the Company.

Lists which are presented in breach of the provisions described are deemed not to have been presented.

Each person entitled to vote in the Meeting may only vote for one list.

The procedure outlined below will be adopted in the election:

- four fifths of the Directors to be elected are selected in the progressive order in which they are listed from the list that obtained the majority of the votes cast rounding down to the nearest whole number, in the case of a fractional number;
- the remaining Directors are appointed from the other lists; for this purpose the votes obtained by the lists will be divided subsequently by progressive whole numbers from one to the number of Directors still to be elected. The quotients obtained in this way are assigned progressively to the candidates of each of these lists, according to the order in which they are listed, respectively. The quotients attributed to the candidates

<sup>4</sup> Article 10 of the Company Bylaws.

<sup>5</sup> Refer to Consob Resolution No. 18452 dated January 30, 2013.

of the various lists are arranged in a single ranking in decreasing order. The persons that obtained the highest quotients are elected.

If more than one candidate obtained the same quotient, then the candidate from the list that has not yet elected a Director or that has elected the fewest Directors is elected.

If none of these lists has yet elected a Director or if all the lists have all elected the same number of Directors, then the candidate who obtained the highest number of votes within these lists is elected. In the case of parity votes on a given list and again with the same quotient, then the votes shall be cast again by the entire Shareholders' Meeting and the candidate who obtains a simple majority of the votes cast is elected.

If application of the voting list mechanism does not assure the minimum number of Independent Directors envisaged by the applicable laws and regulations then the non-independent candidate elected, indicated with the highest progressive number in the list and who received the highest number of votes, will be replaced by the unelected independent candidate from the same list, in accordance with the progressive order of presentation and so on, list by list, until the minimum number of Independent Directors has been completed.

The Shareholders Meeting resolves with the majorities required by law when appointing Directors, who, for whatever reason, were not appointed in accordance with the procedure required by law.

The provisions set out under Article 2386 of the Italian Civil Code will apply if one or more Directors fall from office during the financial year.

Loss of the independence requirements by a Director does not represent a cause for the Director's appointment to lapse provided the minimum number of Direc-

tors, as envisaged by the applicable laws and regulations, in possession of the legal requirements for independence remain in office.

A proposal to supplement the Company Bylaws was submitted to the Shareholders' Meeting convened to approve the 2012 Financial Statements in order to take into account the changes introduced by Law No. 120 dated July 12, 2011 concerning gender quotas in relation to the composition of company bodies of listed companies. In particular, a provision has been introduced to assure a balance between genders, as a result of which the lists to elect the Board of Directors which include a number of candidates equal to or greater than three shall include a number of candidates of the gender less represented that corresponds to at least the minimum number required by the applicable legislation and/or regulations, in compliance with the requirements specified in the Notice of Call of the Shareholders' Meeting. If the application of the voting list mechanism does not assure the required minimum number of Directors from the gender less represented, then an automatic progressive substitution mechanism is established in order to foresee appropriate supplementary criteria which are able to ensure compliance with the balance between genders within the Board of Directors.

It is also proposed to foresee that the balance between the genders within the Board of Directors must be complied with, in any event, when the Shareholders' Meeting or the Board of Directors (in the case of co-option) must appoint Directors without following the voting list procedure. Indeed, in such cases, it is foreseen that the procedure shall ensure that the Directors (or the Director) elected comply with the gender quota envisaged by the applicable legislation and/or regulations pro tempore.

In accordance with best practices, when the Board of Directors is to be renewed it is the Company's accepted practice to allow shareholders to express their opinions with separate votes concerning the following aspects, respectively: (i) establishing the number of members of the Board of Directors (ii) appointing Directors by voting the lists presented (iii) establishing the term of office of the Board of Directors and (iv) establishing the fee due to the Directors.

## 4.2 COMPOSITION

The Company's Board of Directors is composed of no less than 7 and no more than 23 members, in accordance with the Company Bylaws, and remain in office for 3 financial years (unless a shorter period is established by the Shareholders' Meeting at the date of the appointment) and they may be re-elected.

The Board of Directors was composed of 18 Directors<sup>6</sup> at the Date of the Report and was appointed by the Shareholders' Meeting held on April 21, 2011 for 3 financial years, falling from office with the Shareholders' Meeting convened to approve the Financial Statements as of and for the year ending December 31, 2013.

At the Date of the Report the average age of the Directors in office was approximately 62 and with an average term in office corresponding to approximately 5 and a half years.

By adopting the voting list system, the so-called minorities were able to appoint 4 Directors, corresponding to one fifth of the total (in particular, the Directors Franco Bruni, Elisabetta Magistretti, Pietro Guindani and Francesco Profumo<sup>7</sup>).

2 lists were presented to the Shareholders' Meeting held on April 21, 2011: one from the shareholders participating in the Pirelli & C. Shareholders' Agreement (that obtained 84% of the votes of the voting capital represented in the Shareholders' Meeting<sup>8</sup>) and one from a group of institutional investors<sup>9</sup> (who obtained 15.6% of the votes of the voting) capital represented in the Shareholders' Meeting<sup>10</sup>). Those proposing the lists made the candidates' profiles available to permit their personal and professional characteristics be known prior to voting, as well as the fact that some candidates satisfied the requirements to be qualified as independents.

The updated version of the curriculum vitae

of each Director are published on the Pirelli Internet website. The following events occurred during the 2012 Financial Year:

- Pursuant to Article 2386 of the Italian Civil Code, the Board of Directors appointed the Giuseppe Vita to substitute Mr. Cucchiani in the meeting held on March 1, 2012, and in the same meeting, at the proposal of the Appointments and Succession Committee, the Board appointed the Ms. Manuela Soffientini to substitute Prof. Profumo (selected from the minority list). Even though the Appointments and Succession Committee is responsible for defining the candidates to be submitted to the Board to then co-opt the person concerned when an independent Board Member is to be substituted, in this case, the Committee deemed it appropriate to involve Assogestioni to identify the candidate to be submitted to the Board to substitute Prof. Profumo, since representing a Board Member elected from the list presented by institutional investors under the auspices of Assogestioni. The latter proposed a shortlist of two names to the Committee from which the Committee decided to propose Ms. Manuela Soffientini to the Board of Directors, also having considered the opportunity of a further enhancement of the gender diversity within the Board, and, as has been said, Ms. Manuela Soffientini was appointed in the meeting held on March

<sup>6</sup> The Shareholders' Meeting held on April 21, 2011 established that the number of Board Members was to be 20. Prof. Paolo Ferro-Luzzi died on November 11, 2012, he had been appointed on April 21, 2011, and on March 4, 2013 the Director Mario Greco resigned and therefore, two seats are vacant. Therefore, the Shareholders' Meeting convened to approve the 2012 Financial Statements will be called on to resolve accordingly.

<sup>7</sup> Prof. Francesco Profumo resigned from the office of Director on November 16, 2011 following his appointment as a Minister of the Italian Republic.

<sup>8</sup> Data obtained from the summary statement of the votes cast in the Shareholders' Meeting held on April 21, 2011 available on the Pirelli Internet website.

<sup>9</sup> The minority list was presented by: Amber Capital Italia SGR S.p.A. (manager of the Amber Italia Equity fund); Amber Capital LP (manager of the PM Manager Fund, SPC); Amber Global Opportunities Master Fund Ltd.; Anima SGR S.p.A. (manager of the Europa, Sforzesco, Visconteo Italia, Iniziativa Europa, Anima Europa funds); APG Algemene Pensioe Groep N.V. (manager of the Stichting Depository APG Developed Markets Equity Pool fund); Arca Sgr S.p.A. (manager of the Arca Azioni Italia and Arca BB funds); Ersel Sicav; Ersel Asset Management SGR S.p.A. (manager of the Fondersel Italia fund); Eurizon Capital SGR S.p.A. (manager of the Eurizon Focus Azioni Italia and Eurizon Italia 130/30 funds); Eurizon Capital SA (manager of the Eurizon Stars Fund European Small Cap Equity, Eurizon Stars Fund Italian Equity, Eurizon Easy Fund Equity Consumer Discretionary, Eurizon Easy Fund Equity Europe, Eurizon Easy Fund Euro, Eurizon Easy Fund Equity Italy funds); Fideuram Investimenti SGR S.p.A. (manager of the Fideuram Italia fund); Fideuram Gestions SA (manager of the Fonditalia Equity Italy, Fonditalia Euro Cyclical, Fideuram Fund Equity Italy, Fideuram Fund Equity Europe, Fideuram Fund Equity Europe Growth funds); Interfund Sicav (manager of the Interfund Equity Italy fund); Kairos Partners SGR S.p.A. (Manager of Kairos Italia – Speculative Fund); Mediolanum International Funds Limited (manager of the Challenge Funds); Pioneer Asset Management SA; Pioneer Investment Management SGR S.p.A. (manager of the Pioneer Azionario Crescita fund); Pioneer Alternative Investment Management Limited; Prima SGR S.p.A. (manager of the Prima Geo Italia S.p.A. fund).

<sup>10</sup> Data obtained from the summary statement of the votes cast in the Shareholders' Meeting held on April 21, 2011 available on the Pirelli Internet website.

**HONESTY O**

AND ACTION. HONESTY IN SUPPORTING YOUR IDEAS  
AND IN FACING YOUR MISTAKES  
YOUR CREATIVITY, TALENT AND POTENTIALS. HONESTY

**HONESTY TOWARD**

HONESTY IN ECONOMY AND IN POLITICS, ACKNOWLEDGING

**HONESTY TOWARD FUTURE**

ENSURING SUSTAINABLE DEVELOPMENT AND

**IS HONESTY THE BEST**

**F THOUGHT**

**REALS. HONESTY IN ADMITTING YOUR OWN LIMITS  
ES. HONESTY IN RECOGNISING  
Y IN EVERYDAY LIFE, IN FEELINGS AND RELATIONSHIPS.**

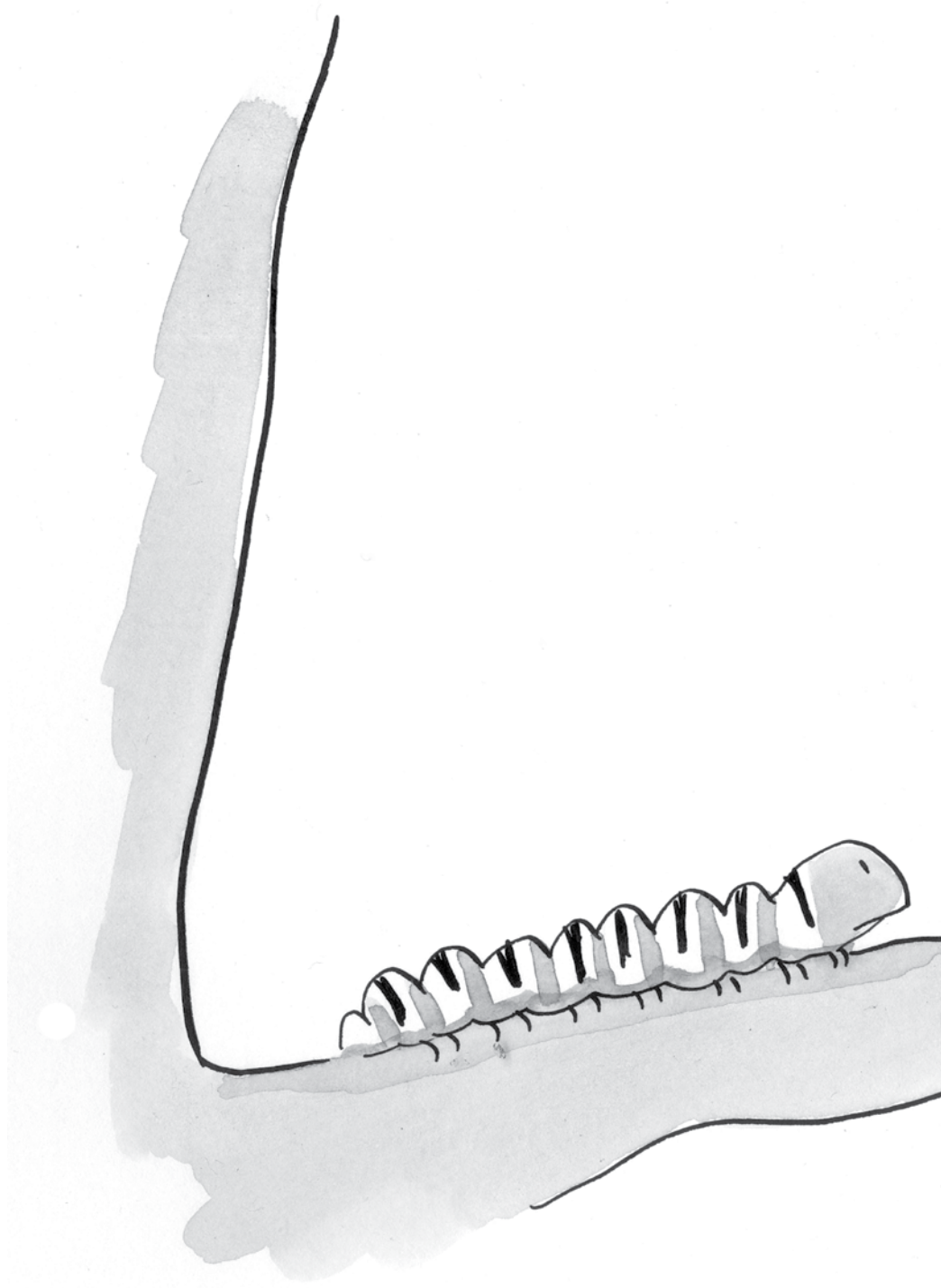
**YOURSELF, TODAY.**

**LEDGING THE URGENT NEED FOR GOOD PRACTICES.**

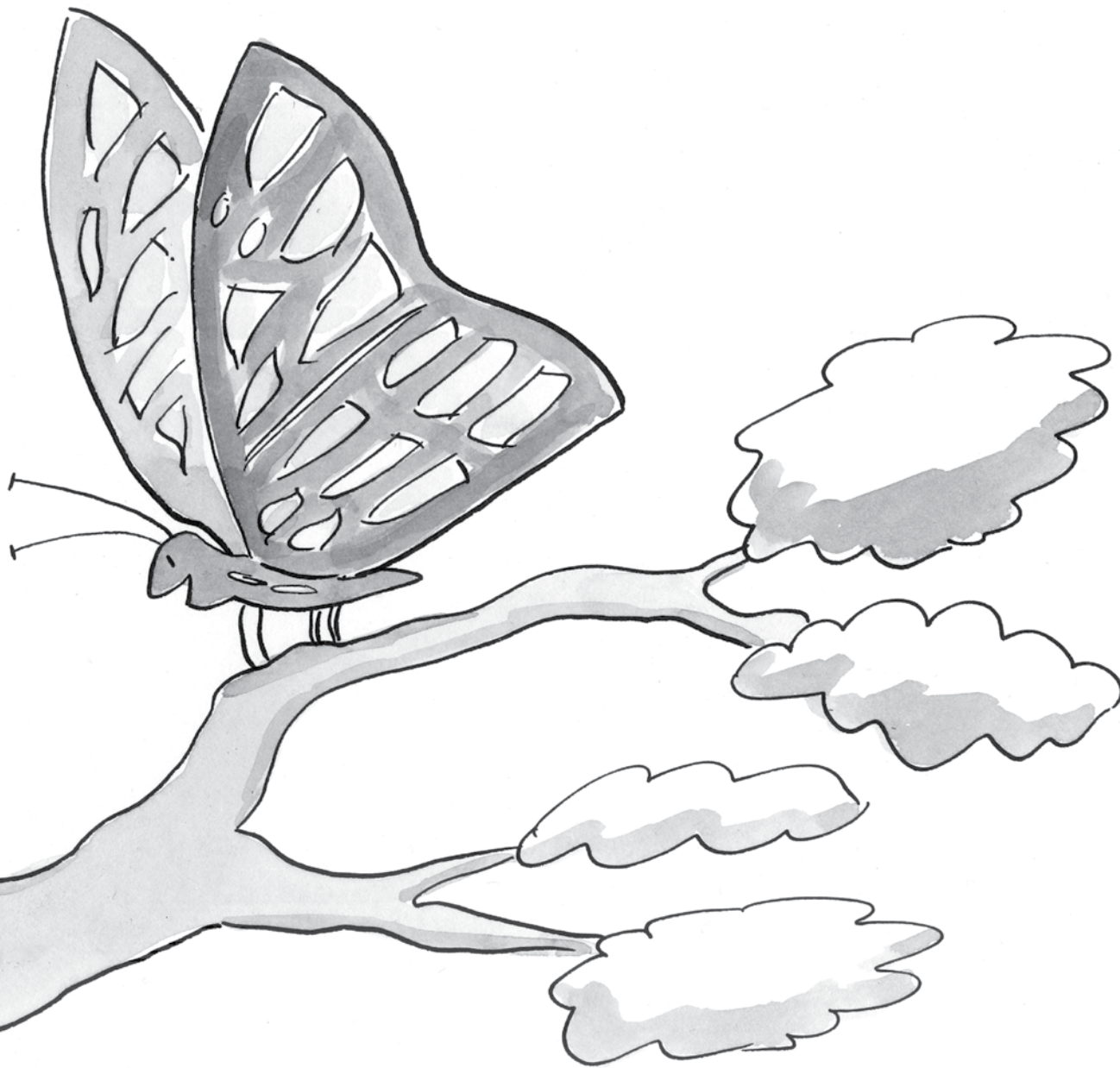
**UTURE GENERATIONS,**

**ND STANDING UP FOR THE COMMON GOOD.**

**BEST POLICY? YES.**



*“I’ll be honest*



DOHHELCI

*with you, it gets better!”*

1, 2012 and confirmed by the Shareholders' Meeting held on May 10, 2012.

The female presence on the Board of Directors corresponded to 20% after this appointment and was thereby immediately in line with the requirements envisaged by Law No. 120 dated July 12, 2011 that amended the Articles of the Unified Financial Law (TUF) relating to the composition of the administration bodies (Article 147-ter) and control bodies (Article 148), and, once fully effective, requires at least one fifth of the gender less represented to have a presence in the company bodies (in the first application). The new provisions will be applicable from the first renewal of the administration and control bodies one year after the date the Law comes into force, therefore, in the case of Pirelli's Board of Directors, starting from the renewal of the Board envisaged with the Shareholders' Meeting convened to approve the Financial Statements as of December 31, 2013.

- The Shareholders' Meeting held on May 10, 2012 confirmed the following Directors: Manuela Soffientini and Giuseppe Vita (the latter later resigned on May 25, 2012 since positions were accepted with the Unicredit Group);
- on July 26, 2012 the Board of Directors appointed Mr. Carlo Salavatori to substitute Mr. Giuseppe Vita and on November 12, 2012 the Board of Directors appointed Mr. Mario Greco to substitute Mr. Giovanni Perissinotto who had resigned on July 23, 2012. Mr. Mario Greco resigned on March 4, 2013;
- Prof. Paolo Ferro-Luzzi died on November 11, 2012.

The Shareholders' Meeting convened to approve the 2012 Financial Statements will be called to resolve to confirm Mr. Carlo Salavatori (who will fall from office at the first Shareholders' Meeting convened after his appointment, since he was co-opted from the Board of Directors) and

with regard to the substitution of Prof. Paolo Ferro-Luzzi and Mr. Mario Greco.

Table 3 illustrates the composition the Board of Directors at the Date of the Report.

#### 4.2.1 MAXIMUM NUMBER OF POSITIONS HELD IN OTHER COMPANIES

The Board of Directors passed a resolution on April 21, 2011, in accordance with the recommendations contained in the Self-Regulatory Code<sup>11</sup>, confirming the Policy<sup>12</sup>, adopted by the Board of Directors in 2007<sup>13</sup>, whereby, in principle, it was deemed that serving as a Director or Auditor in more than 5 companies other than those subject to management and coordination by Pirelli & C. S.p.A. or controlled by or affiliated therewith, was not considered compatible with the role of Director of the company when concerning (i) listed companies included in the FTSE/MIB index (or also in equivalent foreign indexes), or (ii) companies which engage in banking or insurance activities; moreover, it is not deemed compatible for the same Director to hold more than 3 executive positions in the companies described in sub (i) and (ii).

The offices held in several member companies of the same group are considered to be a single office and an executive position prevails over a non-executive position.

The Board of Directors retains the right to make a different assessment and this assessment is disclosed in the Report and the motives are to be duly substantiated.

Shareholders that intended to present lists concerning the Board of Directors' composition are invited to examine the cited policy when the Board of Directors was to be reappointed.

In the meeting held on March 11, 2013 the Board of Directors examined the positions held, as duly notified by the individual Directors, and after examination by the Committee for Internal Control, Risks and Corporate Governance, it was

<sup>11</sup> Self-Regulatory Code: Application criterion 1.C.3.

<sup>12</sup> The cited Policy is annexed to the Report and is also available on the Company's Internet website.

<sup>13</sup> Board of Directors' Meeting held on November 7, 2007. In the meeting held on March 8, 2011 the Board of Directors, after having acknowledged the amendments to the so-called unified banking law which entailed, inter alia, the abrogation of the so-called "special list" of companies operating in the financial sector aimed at the general public (the former Article 107 of Legislative Decree No. 385 of 1993 introduced with Legislative Decree No. 141/2010), resolved to adopt the foregoing amendment in the policy governing the maximum number of offices which previously also included the companies included in the foregoing list among the companies to be considered for the purposes of the "maximum number", consequently, the reference made to such companies was eliminated.



found that all the Directors held a number of positions compatible with the role of a Director of Pirelli & C. in compliance with the policy adopted by the Company. In particular, none of the Directors in office held a number of offices exceeding the maximum number indicated in the Policy.

The principal offices held by the Directors in companies other than member companies of the Pirelli Group are detailed in an annex to the Report<sup>14</sup>.

### 4.3 ROLE OF THE BOARD OF DIRECTORS

The Company Bylaws do not envisage a minimum interval between Board meetings.

Pirelli has circulated a calendar that schedules 4 meetings for the 2013 financial year:

- March 11, 2013: Board of Directors' meeting to examine the draft financial statements and the consolidated financial statements as of December 31, 2012;
- May 7, 2013: Board of Directors' meeting to examine the interim report on operations as of March 31, 2013;
- July 29, 2013: Board of Directors' meeting to examine the half-yearly financial report as of June 30, 2013;
- November 5, 2012: Board of Directors' meeting to examine the interim report on operations as of September 30, 2013.

The Board of Directors' meetings may be convened using telecommunications media which enable all the persons in attendance to participate in the discussion and to have equal access to information.

The Board of Directors' meetings are convened by letter, telegram, telefax or e-mail to be sent to each Director and Statutory Auditor at least 5 days in advance (or in case of urgency, at least 6 hours in advance) compared to the date of the meeting.

Directors and Auditors have always received the necessary documentation and information with sufficient notice in or-

der to express their informed opinion on the matters submitted to their examination.

In general, the documentation to be examined by the Board of Directors is sent during the three days prior to the Board meeting, this notice is generally deemed to be fair for the transmission of documentation<sup>15</sup>.

In the limited and exceptional cases in which it has not been possible to transmit the documentation with adequate notice, complete information concerning the matter to be examined was provided during the Board Meeting, thereby assuring informed resolutions were passed.

#### 4.3.1 FUNCTIONS OF THE BOARD OF DIRECTORS

The Board of Directors plays a central role in the strategic guidance, as well as in supervising the Company's overall business activities, with the power to direct the overall administration and the power to intervene directly in the decisions necessary or useful to achieve the company purpose. The Board of Directors represents the body responsible for making the most important decisions in terms of the economic/strategic aspects or in terms of the structural impact on operations or functional to exercising Pirelli's policy-making and control activity.

In particular, the Board of Directors<sup>16</sup>:

- examines and approves the strategic, industrial and financial plans of the Company and of the Group, periodically monitoring the implementation;
- draws up and adopts the Company's corporate governance rules and defines the Group's corporate governance guidelines;
- defines the guidelines for the internal control system and appoints a Director designated to supervise the internal control system, defining the respective duties and powers;
- supervises the risk management process, defining the acceptable overall risk threshold (so-called risk appetite);
- evaluates the adequacy of the general organisational, administrative and accounting structure of the Company and of the subsidiaries of strategic importance;
- establishes one or more Board Advisory Committees, appointing the members and establishing the duties, powers and fees;

<sup>14</sup> Self-Regulatory Code: Application criterion 1.C.2.

<sup>15</sup> 2011 Self-Regulatory Code: Application criterion 1.C.5.

<sup>16</sup> Self-Regulatory Code: Application criterion 1.C.1., sub-section a).

- confers and revokes the powers on the Managing Directors and on the Executive Committee – if established – defining their limits and operating procedures; also establishes the frequency, however, not more than on a quarterly basis, with which the delegated bodies are to report to the Board concerning the activity performed when exercising the powers of attorney;
- defines the general remuneration policy;
- determines the remuneration of the Managing Directors and the other Directors who have special duties after having examined the proposals submitted by the Remuneration Committee and after consulting with the Board of Statutory Auditors, as well as subdividing the total remuneration due to the Board Members, if the Shareholders' Meeting has not already resolved this aspect;
- evaluates the general operating performance, in particular, taking into consideration the information received from the delegated bodies, as well as periodically comparing the results achieved with the planned results;
- examines and approves in advance the transactions involving the Company and its subsidiaries, when such transactions have a significant strategic, economic, equity or financial impact;
- evaluates the size, composition and operation of the Board and its Committees, at least once a year, possibly expressing opinions concerning the professional figures whose presence on the Board is deemed appropriate;
- establishes the Supervisory Body, pursuant to Legislative Decree No. 231 dated June 8, 2001;
- appoints the General Managers and the Director responsible for preparing the Company's accounting documents, determining their responsibilities and powers and identifies the Directors

with strategic responsibilities;

- appoints and revokes the internal control officer based on the proposal made by the Director appointed to supervise the internal control system and determines the Officer's duties and remuneration, after having heard the opinions of the Committee for Internal Control, Risks and Corporate Governance and the Board of Statutory Auditors;
- assesses and approves the periodic statement documentation envisaged by the applicable laws and regulations;
- assesses and approves the transactions with related parties, in accordance with the conditions envisaged by the Procedure for Transactions with Related Parties;
- prepares the proposals to be submitted to the Shareholders' Meeting;
- exercises the other powers and fulfils the duties assigned to it by law and by the Company Bylaws.

#### **4.4 ACTIVITIES OF THE BOARD OF DIRECTORS**

The Board of Directors met 5 times during the 2012 financial year, each meeting had a duration that exceeded two hours and thirty minutes and the percentage attendance of the Directors exceeded 90% and the percentage attendance of the Independent Directors exceeded 95%.

The Lead Independent Director attended all the Board of Directors' meetings.

2 Board Meetings were held in 2013 at the Date of the Report.

##### **4.4.1 EVALUATION OF THE GENERAL TREND OF OPERATIONS<sup>17</sup> AND STRATEGIC PLANS**

The Board of Directors evaluated the general trend of operations and the foreseeable outlook at least on a quarterly basis, in accordance with the law<sup>18</sup> and the Company Bylaws<sup>19</sup>. More in particular, during the 2012 financial year the Board:

- defined the 2012 Business Plan on the basis of the 2012-2014 Industrial Business Plan with an outlook extended to 2015, (approved in the meeting held on November 8, 2011, as illustrated to the financial community in London on November 9, 2011);
- approved the periodic accounting reports. On these oc-

<sup>17</sup> Self-Regulatory Code: Application criterion 1.C.1., sub-section e).

<sup>18</sup> Article 150 of the Unified Finance Law (TUF).

<sup>19</sup> Article 11 of the Company Bylaws.

casions, the Board received information concerning the results achieved compared with: (i) the historical data; (ii) the budget targets, with a focus on any deviations;

- approved the review of the 2012 targets notified to the market;
- approved independently and in advance compared to the approval of the financial statements, the compliance of the impairment test procedure with the requirements of the international accounting standard IAS 36, as stated in the joint Bank of Italy/Consob/ISVAP document, dated March 4, 2010.

#### 4.4.2 INTERNAL CONTROL SYSTEM AND GOVERNANCE SYSTEM<sup>20</sup>

The Board of Directors also:

- verified the consistency of Pirelli's corporate governance system in the meeting held on March 12, 2012 with the new version of the Self-Regulatory Code (dated December 2011) to which the Board declared its compliance in the same meeting;
- acknowledged the Company's organisational system;
- initiated the verification of the requirements envisaged to be assigned the office as Director referred to each Board Member and the requirements to be qualified as Independent Directors referred to the Directors elected and qualified as such at the date their candidacy was proposed.

The Board of Directors assessed the adequacy of the internal control system on a half-yearly basis, and more in general, the governance system of the Company and of the Group the Company controls.

The Board of Directors adopted some amendments to the Company Bylaws in the Meeting held on November 12, 2012 in order to adapt the Company Bylaws to the

provisions of law introduced following the coming into force of Legislative Decree No. 91 dated June 18, 2011 (so-called shareholders rights corrective decree) that introduced a number of corrective measures to Legislative Decree No. 27/2010 with regard to exercising some rights of shareholders of listed companies and that implemented European Union Directive, so-called shareholders' rights into Italian law. In particular, the Company Bylaws were amended by envisaging that the shareholders' meetings are to be held in a single call, excluding that this right may be delegated to Directors.

The Board of Directors also approved the proposals to amend the Company Bylaws that will be examined by the Shareholders' Meeting convened to approve the 2012 Financial Statements (i) concerning the compliance of the Company Bylaws with the discipline concerning the balance between the genders in the administrative body and the control body of listed companies, (ii) as a consequence of some "new" regulatory provisions concerning, in particular, the shareholding quotas required to present the lists to elect the administrative body and the control body. In this regard, the reader is referred to the Directors' Report to the Shareholders' Meeting available on the Pirelli Internet website

Furthermore, the Board approved the changes to the Organisational Model 231 deemed appropriate to take into account the introduction of the offence relating to "the employment of nationals from third-party countries with an irregular permit to stay" among the presumed offences provided for under corporate liability, pursuant to Legislative Decree No. 231. In particular, the internal control scheme concerning the "selection and hire of staff" was amended that summarises the procedures and accepted practices already in place within the Pirelli Group, by foreseeing a specific control indicator.

In this regard the reader is referred to the section: Code of Ethics, Policies and Organisational Model 231.

Accordingly, the Board of Directors verified the suitability of the means and the powers conferred on the Responsible Officer and endorsed the activities performed by the Responsible Officer for the purposes of issuing the own certificates concerning the Financial Statements as of December 31, 2011, an analogous activity was performed during 2013 in relation to the Financial Statements as of December 31, 2012.

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<sup>20</sup> Self-Regulatory Code: Application criterion 1.C.1., sub-section b).

The Board of Directors endorsed the considerations expressed by the Committee for Internal Control, Risks and Corporate Governance and proceeded to evaluate the Company's overall organisation, administrative and accounting structure and expressed a positive opinion in relation to the internal control system, and more in general, the governance system of the Company and of the Group<sup>21</sup>.

#### 4.4.3 REMUNERATION OF DIRECTORS INVESTED WITH SPECIAL OFFICES

During the 2012 financial year, taking into account the approval of a "new" 2012-2014 Industrial Business Plan the Board of Directors resolved to "close" the 2011/2013 LTI Plan and at the same time to "launch" a "new" 2012/2014 LTI Plan consistent with the new Industrial Business Plan that has objectives which are more challenging compared to the objectives of the 2011/2013 Plan which were already demanding. The new LTI Plan initiated a review that not only concerned the incentive system's objectives (rendering them consistent with the new Industrial Business Plan), but also to reorganise the structure of the overall incentive system.

In the same meeting the Board of Directors approved the Remuneration Policy referred to the 2012 financial year, again based on the proposal by the Remuneration Committee and submitted to the advisory vote of the Shareholders' Meeting convened to approve the 2011 Financial Statements and the Report referred to the 2011 financial year, both the foregoing are available in the Remuneration Report on the Pirelli Internet website.

During the 2013 financial year the Board of Directors approved the Remuneration Report referred to the 2013 financial year comprising the Remuneration Policy re-

ferred to the 2013 financial year and Remuneration Report referred to the 2012 financial year.

The Remuneration Report referred to the 2013 financial year will be made available on the Pirelli Internet website no later than 21 days preceding the Shareholders' Meeting scheduled for May 13, 2013.

#### 4.4.4 TRANSACTIONS OF SIGNIFICANT STRATEGIC, ECONOMIC, EQUITY OR FINANCIAL IMPORTANCE<sup>22</sup>

The Board of Directors is responsible for the prior approval of some actions and transactions which are not intragroup (determined on the basis of qualitative criteria and quantitative thresholds) when executed by Pirelli & C. or by Italian and also foreign companies which are not listed and are subject to management and coordination activities by Pirelli & C.<sup>23</sup>, without prejudice to (i) the responsibilities and powers reserved by law and the Company Bylaws; (ii) the structure of the powers and (iii) internal procedures.

With regard to the last aspect it is important to note that the Board of Directors approved the principal transactions executed during the 2012 financial year.

The Board, inter alia, approved the EMTN (Euro Medium Term Notes) programme, a document platform to issue bond loans on the Euro market up to a maximum amount of 2 billion euro. The programme enables the access times to the market to be minimised and to benefit from the loan opportunities offered by the international capital markets and by qualified investors through the issuance of bonds with various expiry dates and denominated in the main currencies, which can all be executed using the same documentation.

The Board of Directors has authorised the issuance of non-convertible bonds up to a maximum face value of 1 billion euro (or the corresponding counter value in other currencies), in accordance with this programme, the maximum foreseen duration of which is twenty years, the bonds are also to be placed in several tranches on international markets within the end of 2013.

It is important note that the "procedure regarding information flows to Directors and Auditors"<sup>24</sup> envisages general

<sup>21</sup> In this regard the reader is also referred to the paragraph below: "Committee for Internal Control, Risks and Corporate Governance".

<sup>22</sup> Self-Regulatory Code: Application criterion 1.C.1., sub-section f).

<sup>23</sup> In this regard, the reader is referred to the "General criteria to identify transactions with a significant impact: strategic, economic, equity or financial" duly reported in their up-to-date version on the Company's Internet website.

<sup>24</sup> The "procedure regarding information flows to Directors and Auditors" is detailed in the end of the Report and is available on the Company's Internet website.

WHO KNOWS WHETHER THOSE WHO GOVERN US WILL READ THE WRITINGS OF THESE STUDENTS ON THE THEME OF VALUES FOR THE FUTURE. IT WOULD INDEED BE INSTRUCTIVE FOR THOSE WHO ARE RESPONSIBLE FOR OUR TOMORROW. FOR US WHO HAVE READ THEM IT HAS BEEN AN IMPORTANT EXPERIENCE. TO DISCOVER THAT IN REGARDS TO THEIR ROLE IN SOCIETY

# YOUNG PEOPLE

SPEAK ABOUT HONESTY, COMMON GOOD, WINNING IDEAS, HUMILITY, COURAGE, TRUST, SECURITY, TOLERANCE, DETERMINATION AND RESPONSIBILITY, IS TRULY ENCOURAGING, AND IT INDUCES US TO HOPE THAT WHEN THEY WILL BE CALLED TO ADMINISTER POWER, THEY WILL CONTINUE TO THINK IN THIS WAY AND WILL NOT CEASE TO USE THE SAME WORDS. **GIUSEPPE TORNATORE**

information on the activities performed.

#### 4.4.5 TRANSACTIONS WITH RELATED PARTIES

As regards transactions with related parties, the reader is referred to the section “Directors’ interests and transactions with related parties”.

#### 4.4.6 BOARD PERFORMANCE EVALUATION

Since the 2006 financial year, the Board of Directors has performed a self-evaluation process of its performance (so-called “Board performance evaluation”), thereby complying with international best practices and implementing the recommendations contained in the Self-Regulatory Code<sup>25</sup>.

The Board deemed it appropriate to confirm the self-assessment process, also with reference to the 2012 financial year, while innovating its structure based on a proposal by the Committee for Internal Control, Risks and Corporate Governance, and taking into account the positive experience of previous years.

In particular, the Board of Directors developed the idea of implementing a self-assessment process for the 2012 financial year, based on the proposal made by the Committee that permitted a reflection to be made on the assessment tool itself and on how the Board of Directors operates. Accordingly, the self-assessment process referred to the 2012 financial year was dedicated to self-assessing which elements could permit a further improvement of the Board’s operation and the operation of its Committees, as well as to prepare the assessment process for the 2013 financial year that, ideally, will constitute an end of mandate balance referred to the Board in office in order to make a contribution to the Board that will be elected for the

2014/2016 three-year period.

For these reasons the Board of Directors deemed that the most effective method was to entrust the Committee for Internal Control, Risks and Corporate Governance (with the operative support of consultancy firm Spencer Stuart) to manage directly the self-assessment process for the 2012 financial year by means of a questionnaire and meetings between the Committee and the other Directors in order to prepare a final report on the self-assessment process to be presented to the Board of Directors.

The self-assessment process focused on three main areas: (i) the procedures to implement the “new” Self-Regulatory Code; (ii) transactions with related parties (including precisely the transaction referred to the Prelios loan); (iii) the risk management model, and more in general, the internal control system.

Based on the outcome of the self-assessment process the Board of Directors confirmed its appreciation concerning the size, composition and function of the Board itself with reference to the 2012 financial year.

A number of suggestions emerged from the self-assessment to increase further the involvement of the Directors and which confirm the interest and the attention of the single Directors for a proactive participation in Pirelli’s growth. The foregoing also considers that the legislative changes have extended further the duties and responsibilities of Directors.

Special appreciation was dedicated to the work performed by the Committees.

As regards the size, composition and function of the Board it was noted that Pirelli’s Board included persons of high personal and professional standing.

The Board also defined the actions which can already be implemented immediately to respond to the suggestions made during the self-assessment process. In particular, the opportunity to continue to organise informal meetings of the Board of Directors was endorsed - also with the involvement of senior managers - also directly inside production facilities concerning single business aspects (both with the aim of induction and with the aim of achieving a greater involvement of the Directors).

<sup>25</sup> Self-Regulatory Code: Application criterion 1.C.1., sub-section g).

#### 4.4.7 ARTICLE 2390 OF THE ITALIAN CIVIL CODE

Article 10, last paragraph of the Company Bylaws envisages that the Directors are not bound by the competition prohibition set out under Article 2390 of the Italian Civil Code, unless otherwise resolved by the Shareholders' Meeting.

### 4.5 DELEGATED BODIES

#### 4.5.1 CHAIRMAN AND MANAGING DIRECTOR

The Board of Directors appoints its Chairman, in accordance with the Company Bylaws when the Shareholders' Meeting has not already done so. The Board of Directors appointed Marco Tronchetti Provera as Chairman and Managing Director in the meeting held on April 21, 2011.

The Chairman is the Company's legal representative.

The Chairman and Managing Director, Marco Tronchetti Provera, is responsible for the following organisational functions:

- relations with shareholders and the information provided to them;
- defining the strategies concerning the general policy and the development policy for the Company and the Group, as well as the extraordinary transactions to be submitted to the Board of Directors;
- proposals to appoint General Managers and the remuneration due and payable to them, after having consulted the Remuneration Committee;
- all forms of communications to the market.

The Chairman of the Board of Directors shall use all reasonable endeavours so that the documentation relating to the items on the Agenda is submitted to the Directors and to the Auditors suitably in advance

to permit the Directors to express an informed opinion on the topics to be examined by them, in accordance with the Self-Regulatory Code<sup>26</sup>. In this regard, the reader is referred to the section: "Role of Board of Directors".

The Chairman and Managing Director is conferred with full powers – to be exercised with separate signature – necessary to perform the actions concerning the Company's business in its various executions, none excluded. All the foregoing with the power to issue special and general mandates, conferring on the representative the authority to sign, individually or collectively, on behalf of the company and with the responsibilities he shall deem appropriate to assure the Company's best interests, including the power to subdelegate.

The Board of Directors has identified the limits to the management powers conferred on the Chairman and Managing Director, which have been qualified as the internal limits of the relationship between the delegating collegial body and the person with delegated powers. In particular, the following internal limits have been identified: the power to issue guarantees for the Company's bonds and the subsidiaries' bonds for a value exceeding euro 25 million, or in the interests of third parties concerning bonds with a value exceeding euro 10 million; in the latter case the Chairman's signature is to be accompanied by that of another legal representative with similar powers (in particular, reference is made to "Executives with strategic business responsibilities").

#### 4.5.2 COMPANY ORGANISATION

The Board of Directors redefined the organisation model during the financial year.

In particular, in a market that is increasingly competitive and selective in relation to the product and a market that is expanding continuously from the geographical aspect, Pirelli decided to enhance its technological and commercial presence associated with the various business areas, by completing the redefinition of the organisation model initiated in October 2011 by means of a further shortening of the decision-making chain so as to streamline the implementation of the action plans which originate from the Premium strategy. The new structure envisages substi-

<sup>26</sup> 2011 Self-Regulatory Code: Application criterion 1.C.5.

tuting the Executive Office<sup>27</sup> (established when the 2012-2014 Industrial Business Plan was launched) and the concurrent creation of two new roles reporting directly to the Chairman and the Managing Director: the Chief Technical Officer (“CTO”) and the Chief Commercial Officer (“CCO”). The “Product”, “Processes”, “Quality” and “Original Equipment” functions, in addition to the Team Motorsport report to the “CTO”. In particular, the direct coordination of the original equipment function allows the CTO to optimise relations with the car manufacturers and to render the processes associated with experimentation and product development more efficient.

Whereas, the “Marketing”, “Sales” and “Retail” functions report to the “CCO”, with the objective of enhancing the commercial presence and also to assure the coordination of the various geographical areas.

The “Planning and Controlling”, “Operations” and “Supply Chain” functions, in addition to the staff functions report directly to the Chairman with the task of supporting all the business units transversely. Lastly, the “Motorcycle”, “Industrial” (that unifies truck, agro and steel cord), “Environmental Products and Services” and “PZero Fashion” business units report to the Chairman and to the Managing Director.

From the geographical presence point of view, the new model envisages redefining the various markets by identifying eight Regions which correspond to the different business macro areas, in particular: “Central Europe”, “South Europe”, “North-West Europe”, “Russia and Nordics”, “Africa, ME and India”, “Apac”, “Latam” and “Nafta”. The Regions report to the “CCO” for all the commercial and marketing activities.

The Management Committee meets once a month to verify constantly the Group’s economic performance; the development of programmes, plans and initiatives common to the Group and the Business Units

or Regions which have a common importance.

Moreover, the Board of Directors qualified the following Executives with strategic responsibilities (confirming them), during the meeting held on April 21, 2011, since they have the power to adopt management decisions which can impact the development and future prospects: Francesco Chiappetta, lawyer (General Counsel and Manager of General and Institutional Affairs); Francesco Tanzi (Administration and Finance Manager and Responsible Officer) and Maurizio Sala (Planning and Control Manager)<sup>28</sup>.

The powers relating to the specific functions assigned were attributed to the above-mentioned Executives with strategic business responsibilities.

More limited powers, to be used in the framework of the respective responsibilities, were also conferred on other senior managers and managers.

#### 4.5.3 INFORMATION TO THE BOARD

The Board of Directors and the Board of Statutory Auditors are kept informed of the activities performed, the general performance, the foreseeable outlook and the most significant transactions with a strategic, economic, financial and equity impact, carried out by the Company or by its subsidiaries, in accordance with the provisions envisaged by law<sup>29</sup> and by the Company Bylaws<sup>30</sup>.

Pirelli believes that the completeness of the information made available to the Directors represents an essential condition to exercise correctly the tasks and responsibilities in management, policy-making and control inherent to the position of Directors and Statutory Auditors.

For this reason, Directors and Statutory Auditors receive a continuous flow of information from the Executive Directors to assure the transparency of company management; to assure the conditions to achieve an efficient and effective guidance and control of the Company’s activities and operation of the business by the Board of Directors and to provide the Board of Statutory Auditors with the information required to perform its role efficiently.

Where appropriate, the delegated bodies report on the

<sup>27</sup> The Executive Office comprised the Chairman and the Managing Director Marco Tronchetti Provera and the Chief Operating Officer Francesco Gori. Mr. Francesco Gori left the Pirelli Group on May 10, 2012 tendering his resignation as General Manager of Pirelli & C. and as Managing Director and General Manager of Pirelli Tyre.

<sup>28</sup> Francesco Gori, General Manager was an executive with strategic responsibilities up to May 10, 2012.

<sup>29</sup> Article 150, paragraph 1 of the Unified Finance Law (TUF).

<sup>30</sup> Article 11 of the Company Bylaws.



transactions in which they have an interest, in their own right or on behalf of third parties. The notification is made promptly, and however, at least every three months, at the date of the Board of Directors' meetings (and the meetings of the Executive Committee, if appointed) or by means of a written memorandum.

The Company has developed a special procedure to favour the orderly organisation of the flow of information, this procedure has been implemented since July 2002 and defines in detail, the rules to be followed in order to comply with the information reporting obligations.

The Procedure was also updated to take into account the new requirements introduced to the internal regulatory system by the Procedure for Transactions with Related Parties and aims to regulate and coordinate all the various forms of information flowing to Directors and Statutory Auditors, since they are united by the common aim of making the information required to exercise correctly their management, policy-making and control responsibilities continuously available to the Directors and Statutory Auditors.

The updated version of the Procedure on information flows to Directors and Statutory Auditors is reported on the Pirelli Internet website.

#### 4.6 OTHER DIRECTORS

The Board of Directors has considered that the Chairman of the Board of Directors, Marco Tronchetti Provera and the Deputy-Chairman, Alberto Pirelli are Executive Directors, the latter by virtue of his operative positions in the subsidiary Pirelli Tyre. Several working lunches were organised during the financial year designed to examine in greater detail specific business and corporate governance issues, to increase the knowledge of all Directors and

Auditors concerning the Company's reality and dynamics and in compliance with the recommendations of the Self-Regulatory Code<sup>31</sup> and with what is now a consolidated practice within the Company. In particular, an in-depth examination of the Pirelli retail distribution model was performed produced important acquisitions during 2012 (Campneus and Dackia) and the project development plans were examined. The roles and operation of the newly established committees were also discussed. In particular, the role and operation of the Strategies Committee was discussed in a meeting open to all Board Members, while the Independent Directors examined the role and function of the Appointments and Succession Committee in a meeting that was not attended by the other Directors.

#### 4.7 INDEPENDENT DIRECTORS

The Company's Board of Directors has been characterised from 2006 by a number of Independent Directors who represent the absolute majority of its members, with a more rigorous approach of the Self-Regulatory Code that in the case of member companies of the FTSE-MIB index makes a recommendation that at least one third of the Board is to be comprised of Independent Directors<sup>32</sup>. However, in the case of Pirelli this recommendation will be applied with effect from the next mandate, namely, from the date of renewal of the Board of Directors that will fall from office with the approval of the financial statements as at December 31, 2013. At the date of their appointment and subsequently once a year, the Board assesses the continued validity of the requirements of independence envisaged by the Self-Regulatory Code and the requirements envisaged by the Unified Finance Law (TUF) in relation to non-executive Directors who are qualified as Independent.

The Board of Directors identifies the independence of its Directors in terms of their freedom from relations with the Company and/or its principal shareholders and executives which may influence their opinion.

The Board referred to the requirements recommended by the Self-Regulatory Code<sup>33</sup> for the purpose of performing the respective assessment, and, accordingly, a given Director cannot - as a rule - be deemed independent:

<sup>31</sup> Self-Regulatory Code: Application criterion 2.C.2.

<sup>32</sup> 2011 Self-Regulatory Code: Application criterion 3.C.3.

<sup>33</sup> 2011 Self-Regulatory Code: Application criteria 3.C.1. and 3.C.2.

- if the Director concerned controls Pirelli & C. directly or indirectly, also through subsidiaries, trust companies or third parties, or is able to exercise considerable influence on the company, or participate in a shareholders' agreement through which one or more parties can exercise control or have a significant influence on Pirelli & C.;
- if the Director concerned is or has been in the preceding three financial years, a prominent member<sup>34</sup> of Pirelli & C., one of its strategic subsidiaries or a company subject to joint control with Pirelli & C., or a company or body that, also together with others, controls Pirelli & C., based on a shareholders' agreement, or is able to exercise considerable influence on it;
- if the Director concerned, directly or indirectly (for example: through subsidiaries or companies in which the Director is a prominent member, or as a partner of a professional firm or a consulting company), has or had an important commercial, financial or professional relationship in the previous financial year:
  - ■ with Pirelli & C., one of its subsidiaries, or with any respective prominent representatives;
  - ■ with a party that controls Pirelli & C., also together with others, based on a shareholders' agreement, or with the respective prominent representatives, in the case of a company or body;
 or is or was an employee of one of the foregoing parties in the previous three financial years;
- if the Director concerned receives or received from Pirelli & C. or from one of its subsidiaries, in the previous three financial years, a significant supplementary remuneration, in addition to the "fixed" salary as a non-executive Director of Pirelli & C., and a fee for participating in committees recommended by the Self-Regulatory Code, also in the form of participation in corporate performance-based incentive plans, also based on share options;
- if the Director concerned was a Director of Pirelli & C. for more than nine months over the last twelve years;
- if the Director concerned is an Executive Director in another company in which an Executive Director<sup>35</sup> of Pirelli & C. is a Director;
- if the Director concerned is a partner or Director of a member company or a member body of the network of the company mandated to perform the statutory audit<sup>36</sup> of Pirelli & C.;
- if the Director concerned is a close family member of a person who finds themselves in one of the situations described in the preceding points.

The Board of Directors confirmed the applicability of the requirements of independence in the meeting held on March 11, 2013, in the light of a substantial evaluation of the information provided by the Directors and the information available to the Company, also on the basis of the requirements envisaged by the Unified Finance Law (TUF), in relation to the Directors in office at that date and who were qualified as Independent at the date in their appointment and in particular: Carlo Acutis; Anna Maria Artoni; Alberto Bombassei; Franco Bruni; Luigi Campiglio; Pietro Guindani; Elisabetta Magistretti; Luigi Roth, Carlo Secchi and Manuela Soffientini.

It is important to note of the Board of Directors focused on the position of the Directors Acutis and Sechi and considered that they had exceeded nine years in office during the last twelve years, since they had been appointed Directors of Pirelli for the first time on May 7, 2003 and on February 19, 2004, respectively. In particular, the Board of Directors noted that based on the personal characteristics and the proven professionalism, in addition to the specific experience gained by Director Acutis (at least 40 years successful managerial and entrepreneur experience, as confirmed by the fact that Director Acutis has received important international and national awards) and by Director Secchi

<sup>34</sup> In general terms the following are to be considered "prominent representatives" of a company or body: the Chairman of the body, the legal representative, the Chairman of the Board of Directors, the Executive Directors and the Executives with strategic responsibilities in the company or in the body considered.

<sup>35</sup> The Executive Directors of the Company issuing the Report are: the Chairman and Managing Director, Marco Tronchetti Provera and the Deputy Chairman, Alberto Pirelli.

<sup>36</sup> The Company appointed to audit the accounts of Pirelli & C. is Reconta Ernst & Young S.p.A. a member of the Ernst & Young network (Refer to Section 12.4).

(more than 40 years academic experience at the highest national and international levels; senior national and international political appointments, and above all, having held the position as a Director of major listed companies) the fact that the foregoing Directors have exceeded nine years in office as a Director of Pirelli during the last twelve years does not appear to compromise their qualification as Independent Directors in any way. For further details of the professional profile of Director Acutis and Director Secchi the reader is referred to the respective curriculum vitae available on the Pirelli Internet Website.

A further six Board Members (the deputy-Chairman Vittorio Malacalza and the Board Members Gilberto Benetton; Giulia Maria Ligresti; Massimo Moratti; Renato Pagliaro and Carlo Salvatori) were eligible to be qualified as “non-executive Directors”. It follows that the Independent Directors represent the majority of the Directors in office and approximately 2/3 of the total number of “non-executive Directors”. The average age of the Independent Directors at the Date of the Report is just over 63 with an average term in office that corresponds to approximately 5 years.

The Board of Statutory Auditors verified that the assessment criteria and procedures adopted by the Board to establish the independence of its members were applied correctly, in line with the recommendations of the Self-Regulatory Code<sup>37</sup>.

#### 4.7.1 MEETINGS OF THE INDEPENDENT DIRECTORS

In line with the recommendations of the Self-Regulatory Code<sup>38</sup>, the Independent Directors met 3 times during the 2012 financial year in the absence of the other Directors. The Independent Directors examined in detail issues relating to Pirelli’s relationship with the “market” and the methods of communication with the market concerned and the Company’s corporate governance system confirming their special attention to these aspects, as has become accepted practice.

#### 4.7.2 ROLE OF INDEPENDENT DIRECTORS ON COMMITTEES

Pirelli deems that the central function of the Board of Directors is to define the strategic policy guidelines and to supervise the Company’s business activities and in order to perform this important task effectively a central role is represented by the presence on the Board of Directors of an adequate number of Independent Directors with high professional and personal skills and expertise, and, all the more so, on the Committees. As has been said, this applies in particular, from 2006, since the majority of the Board of Directors is composed of Independent Directors and the Remuneration Committee and the Committee for Internal Control, Risks and Corporate Governance are composed only of Independent Directors from 2000; a significant representation is assured in the framework of the Appointments and Succession Committee and the Strategies Committee; in particular, the majority of the members of the latter Committee are Independent Directors and its composition reflects the mix of skills and expertise and the presence of executive, non-executive and independent Directors of the Board of Directors.

Lastly, all the Independent Directors (including all the Directors elected by the so-called minorities) sit on at least one Committee.

<sup>37</sup> Self-Regulatory Code: Application criterion 3.C.5.

<sup>38</sup> Self-Regulatory Code: Application criterion 3.C.6.

#### 4.8 LEAD INDEPENDENT DIRECTOR

The Board of Directors decided to introduce the figure of the Lead Independent Director already in November 2005, in order to further enhance the role of the Independent Directors.

The Lead Independent Director (identified as the Independent Director Carlo Secchi, Chairman of the Committee for Internal Control, Risks and Corporate Governance) represents the key figure to coordinate the requests and contributions made by Independent Directors.

In this capacity, the Lead Independent Director:

- collaborates with the Chairman of the Board of Directors to achieve the best functioning of the Board;
- has the authority to convene meetings, also informal meetings, involving only the Independent Directors, independently, or at the request of the other Directors in order to discuss issues in relation to the functioning of the Board of Directors, in particular, and the Corporate Governance System, more in general, with the possibility of also sending management representatives to discuss with the organisational structure;
- to collaborate with the Chairman of the Board of Directors in order to ensure that the Directors receive complete and timely information flows.

The Lead Independent Director can avail of the collaboration of the Board of Directors' Secretary when exercising his powers.

The Lead Independent Director has participated in all the Board of Directors' meetings in the framework of the mandate received up to the Date of the Report, in all the meetings of the Committee for Internal Control and Corporate Governance and the Lead Independent Director has been constantly in contact with the Chair-

man of the Board of Directors, as in the past, also with reference to the 2012 financial year, precisely to achieve a constant improvement of the Board information process.

The Lead Independent Director also organised three meetings during the 2012 financial year involving only the Independent Directors, as mentioned previously, to examine in detail issues relating to the Company's corporate governance system, confirming their special attention paid to these aspects, as has become accepted practice.

### **5. PROCESSING CORPORATE INFORMATION**

#### 5.1 INTERNAL MANAGEMENT AND DISCLOSURE OF DOCUMENTS AND INFORMATION

Market transparency, fair, complete and clear information represent the values which are upheld by the conduct of the corporate bodies, the management and all the staff employed by Pirelli.

In this context the Board of Directors adopted a Procedure from March 2006 to manage and disclose privileged information to the market that takes into account the regulations concerning market abuse, governs the management of privileged information concerning Pirelli & C., its unlisted subsidiaries and the listed financial instruments issued. The Procedure applies to all members of the corporate bodies, the employees and external collaborators of Pirelli companies that have access to information that could evolve into privileged information.

The Procedure also applies as an instruction to all subsidiaries, in order to obtain from them, without delay, the information required for the timely and correct compliance with the reporting obligations to the general public.

In line with the regulatory provisions, the Procedure defines:

- the requirements and responsibilities to classify privileged information;
- the procedures to trace access to privileged information in transit;
- the tools and rules to protect the confidentiality of privileged information in transit;
- the operational provisions to disclose privileged information to the market and, in general, concerning the communications to the general public and/or to

analysts/investors.

The updated version of the Procedure is available on the Pirelli Internet website, and also governs the institution of the register of persons with access to privileged information, also in operation from April 1, 2006.

## 5.2 INSIDER DEALING

The issue concerning the transparency of transactions involving the Company's shares or the financial instruments linked to them, performed directly or through third parties by relevant persons or by persons closely related to them (so-called insider dealing) is currently governed entirely by law and by the Consob implementation regulation.

In accordance with law, the Directors and Statutory Auditors, inter alia, of the issuing company, as well as "persons who perform management [...] functions in a listed issuing company and Directors that have regular access to privileged information [...] and have the power to make management decisions which can impact the performance and the future prospects of the listed issuing company" are under an obligation to disclose information to the market concerning the transactions performed involving the Company's shares or the financial instruments linked to them with a counter value exceeding euro 5 thousand annually.

The Company has opted to identify these Executive Managers among its "Executive Managers with strategic responsibilities"<sup>39</sup>. Although no regulatory obligations are applicable in this regard, the Board of Directors has decided to continue to impose an obligation on the parties indicated above not to perform transactions involving the Company's shares or involving financial instruments linked to them during specific periods of the year (so-called Blackout

periods<sup>40</sup>), in harmony with the approach adopted in the previous mandate. Moreover, these periods may be extended or suspended by the Board of Directors in extraordinary circumstances.

During the 2012 financial year the obligations set out in the insider dealing discipline and the self-regulatory obligations relating to the so-called blackout periods were extended for internal purposes to all the persons forming part of the Management Committee and to the Directors of the subsidiary Pirelli Tyre.

## 6. BOARD COMMITTEES

The Committees set up within the Board have fact-finding, proposing and/or advisory duties in relation to the issues which particularly require an in-depth examination so that there can be an effective and informed discussion of opinions on such issues.

It is a consolidated practice in Pirelli, in harmony with best practices, for the Board to formally define the duties and powers of the specific committee at the date the committee is established (by means of a so-called written charter), and to render them public by publication on the Pirelli Internet website and also reporting on them in this Report.

The Board of Directors set up four committees following its reappointment, on April 21, 2011, including two new committees: the Committee for Internal Control, Risks and Corporate Governance<sup>41</sup>, the Remuneration Committee; the Appointments and Succession Committee and the Strategies Committee.

The composition of the Board Committees is detailed in table 4.

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<sup>39</sup> In this regard the reader is referred to the paragraphs "delegated bodies" and "Company organization".

<sup>40</sup> The procedure relating to the blackout periods is available on the Company's Internet website.

<sup>41</sup> This name was adopted from September 1, 2009 substituting the name "Committee for Internal Control and Corporate Governance".

## 7. APPOINTMENTS AND SUCCESSION COMMITTEE

### 7.1 COMPOSITION

The Board of Directors set up the Appointments and Succession Committee in the meeting held on April 21, 2011, also taking into account the in-depth studies performed in the previous mandate.

The Appointments and Succession Committee is composed of 4 Board Members, the majority of whom are non-executive Directors (2 Independent Directors)<sup>42</sup>.

The Appointments and Succession Committee was composed as follows at the Date of the Report<sup>43</sup>:

- Marco Tronchetti Provera (Chairman);
- Luigi Campiglio;
- Vittorio Malacalza;
- Luigi Roth.

The Senior Advisor Human Resources, Gustavo Bracco acts as the Committee's Secretary.

### 7.2 DUTIES ASSIGNED TO THE COMMITTEE

When defining the duties of the Appointments and Succession Committee the Board of Directors assessed the increasing importance for Pirelli and the market of the Board's direct involvement in defining the succession policies (i) not only and not just in relation to possible natural changes of the Executive Directors, for which however the decisions made by the shareholders assume a decisive role, but in general (ii) concerning the top and senior management to assure the necessary continuity of the management action.

Accordingly, the Committee:

- proposes to the Board of Directors the candidates to be co-opted, if an Inde-

pendent Director is to be substituted;

- proposes the definition of "emergency" succession plans concerning the Company's top Management by identifying professional figures (inside and outside Pirelli) who can assure the succession, in particular, of the C.E.O.;<sup>44</sup>
- identifies the criteria for the succession plans in relation to the top and senior management, in general, in order to ensure continuity in the business strategies;
- periodically examines the organisational structure of the Company and the Group presenting possible suggestions and opinions to the Board in this regard.

### 7.3 OPERATION

The Committee meets whenever its Chairman deems it appropriate, or whenever a request is made by at least one member, by the Chairman of the Board of Directors or by the Managing Director, if appointed, and however, as often as appropriate to ensure the Committee performs its functions correctly.

The Committee's meetings are convened by a notice, also sent by the Secretary, duly appointed by the Committee Chairman.

The documentation and the information available (and in any event, the documentation and information required) are transmitted to all the Committee members sufficiently in advance to enable the members to express their opinion in the meeting.

The Committee's meetings are validly constituted provided the majority of its members in office are present and the resolutions are passed with the absolute majority of the members in attendance. The Committee's meetings may also be held using telecommunications media and are regularly reported under the Secretary's responsibility and transcribed in the special register.

The Committee may avail itself of external consultants when performing its functions and has adequate financial

<sup>42</sup> The 2011 Self-Regulatory Code (Principle 5.P.1) recommends the establishment of an Appointments and Successions Committee with the majority of its members being Independent Directors. In the case of Pirelli the application of this principle will be effective from the next renewal of the Board of Directors with the approval of the financial statements as at December 31, 2013. The current Committee was established in accordance with the 2006 Self-Regulatory Code that did not include the Appointments and Successions Committee among the Committees recommended by the Self-Regulatory Code concerned, but only envisaged that the Board should assess establishing such a Committee.

<sup>43</sup> The reader is referred to Table 4 for further details.

<sup>44</sup> It is important to note that at the time the Appointments and Successions Committee was set up its duties also envisaged assuring "emergency" succession plans for the C.O.O. As indicated earlier the C.O.O. Francesco Gori resigned from this office on May 10, 2012.

resources to perform its duties with absolute expenditure autonomy.

The Committee has the authority to access company information and functions which are important to perform its duties and can avail itself of the Secretary's support for this purpose.

The Chairman of the Board of Statutory Auditors has the authority to participate in the Committee's meetings.

## 7.4 ACTIVITIES PERFORMED DURING THE FINANCIAL YEAR

The Appointments and Succession Committee met once during the 2012 financial year; the duration of the meeting was approximately 2 hours. All the Committee members attended the meeting; the tables provided at the end of the Report summarise the participation of the members at the Committee's meetings.

In particular, the Committee submitted the proposal to the Board of Directors to appoint Ms. Manuela Soffientini to substitute Prof. Francesco Profumo (a Director drawn from the minority list and who resigned from office following his appointment as a Minister of the Italian Republic), in accordance with Article 2386 of the Italian Civil Code. In this case, even though the Appointments and Successions Committee is responsible for defining the candidates to be submitted to the Board for co-optation in order to substitute an Independent Director, the Committee concerned deemed it appropriate to involve Assogestioni to identify the candidate to be proposed to the Board to substitute Prof. Francesco Profumo, since he was a Director elected from the list presented by institutional investors under the auspices of Assogestioni. The latter proposed a list of two names to the Committee from which the Committee, also considering the expe-

diency of further enhancing the gender difference on the Board, decided to propose Ms. Manuela Soffientini to the Board of Directors, who, as has been said, was appointed in the Meeting held on March 1, 2012.

In the same meeting the Committee identified a company with expertise in this area and subsequently appointed the company to support Pirelli in the Governance of the top and senior management succession plans, and the appointed company reported on the work performed at the beginning of 2013. In this regard, the reader is also referred to the "Succession Plans" section.

The Committee met once during the 2013 financial year at the Date of the Report.

## **8. STRATEGIES COMMITTEE**

### 8.1 COMPOSITION

The Board of Directors set up the Strategies Committee in the meeting held on April 21, 2011, also taking into account the in-depth studies performed in the previous mandate and subsequently supplemented on July 26, 2012 with the appointment of the Directors Bombassei and Soffientini as members of the Committee.

The Strategies Committee is composed of 7 Board Members at the Date of the Report, the majority of whom are Independent Directors). The General Counsel Francesco Chiappetta<sup>45</sup> is also a member of the Strategies Committee. The Strategies Committee was composed as follows at the Date of the Report, also taking into account the resignation of Prof. Francesco Profumo<sup>46</sup>:

- Marco Tronchetti Provera (Chairman);
- Alberto Bombassei
- Franco Bruni;
- Vittorio Malacalza;
- Renato Pagliaro;
- Manuela Soffientini;
- Carlo Secchi;
- Francesco Chiappetta;

The Managers of the Investor Relations (Valeria Leone) and the Sustainability and Risk Management Departments (Filippo Bettini) act as Secretaries to the Committee.

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<sup>45</sup> The C.O.O. Francesco Gori was also a member of the Strategies Committee up to May 10, 2012.

<sup>46</sup> The Reader is referred to Table 4 for further details.

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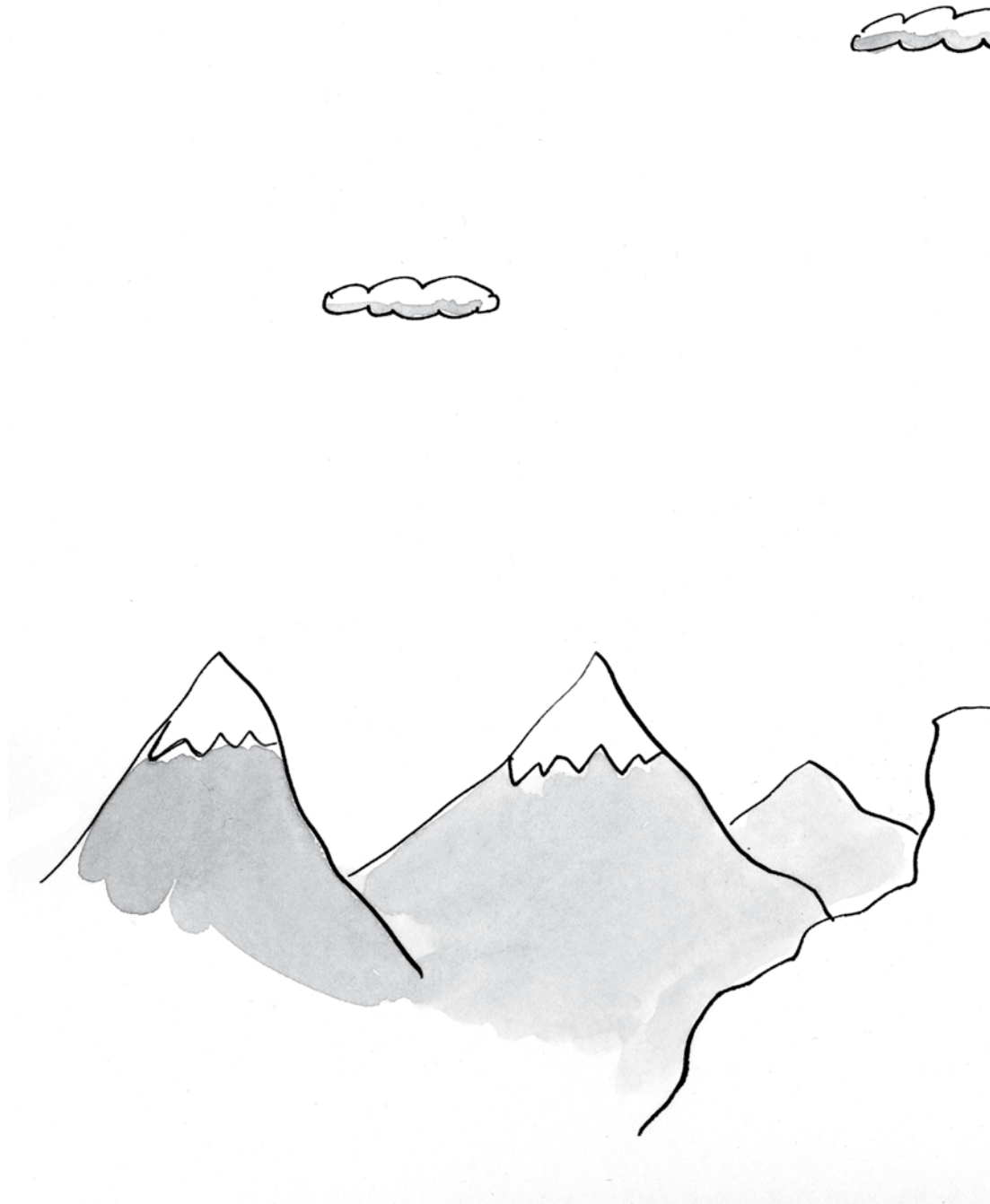
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**EVER, NOT EASY...**



*“There is no simple  
the answer*



DONNELLY

*le answer, my son. But  
could be simple.”*

## 8.2 DUTIES ASSIGNED TO THE COMMITTEE

The Committee has advisory and proposing functions when defining the strategic guidelines, as well as to identify and define the terms and conditions of individual transactions of strategic importance.

In particular, the Committee:

- examines in advance the strategic, industrial and financial plans, also long-term plans of the Company and of the Group to be submitted to the examination of the Board of Directors;
- supports the Board to assess transactions, initiatives and activities of strategic importance and, in particular:
  - ■ entry in new markets, both geographic and business;
  - ■ industrial alliances (for example: joint-ventures);
  - ■ extraordinary transactions (merges, spin-offs, share capital increases or decreases other than decreases due to losses);
  - ■ investment projects;
  - ■ industrial and/or financial restructuring programmes and projects.

## 8.3 OPERATION

The Committee is appointed by the Board of Directors (and the Board also indicates the Committee's Chairman) and remains in office for the Board of Directors' entire mandate.

The Committee meets whenever its Chairman deems it appropriate, or when a request is made by at least one member, by the Chairman of the Board of Directors or by the Managing Director, if appointed, and however, as often as appropriate to ensure its functions are performed correctly. The Committee appoints the secretary of its meetings.

The Committee's meetings are convened

by a notice, also sent by the secretary, at the request of the Committee Chairman.

The documentation and the information available (and in any event, the documentation and information required) are transmitted to all the Committee members sufficiently in advance to enable the members to express their opinion in the meeting.

The Committee's meetings are validly constituted provided the majority of its members in office are present and the resolutions are passed with the absolute majority of the members in attendance. The Committee's meetings may also be held using telecommunication media and are regularly reported under the responsibility of the Secretariat office and transcribed in the special register.

The Committee has adequate financial resources to perform its duties with absolute expenditure autonomy and may avail itself of external consultants when performing its functions.

## 8.4 ACTIVITIES PERFORMED DURING THE FINANCIAL YEAR

The Strategies Committee met 2 times during the 2012 financial year; the average duration exceeded one hour and the tables illustrated at the end of the Report summarise the participations of the members in the Committee's meetings recorded during the financial year.

The Committee, inter alia, examined the investment project in Indonesia and, in particular, the agreement with PT Astra Otoparts, a leading Indonesian company that manufactures components for the automotive sector, concerning the construction of a new production facility in Indonesia, Pirelli's first facility in the country and intended to manufacture conventional motorcycle tyres. The agreement envisages the creation of a joint-venture that will place Pirelli in a majority position with 60% of the capital and Astra with the remaining 40%.

The Committee examined the EMTN programme, in relation to which the reader is referred to the following section: "Transactions of significant strategic, economic, equity or financial importance" and also endorsed the redefinition of the organisation model in relation to which the reader is referred to the "Company Organisation" section.

## 9. REMUNERATION COMMITTEE

### 9.1 COMPOSITION

The Corporate Governance System that has been adopted by Pirelli & C. since 2000 envisages establishing a Remuneration Committee.

The Committee is composed of four members who are exclusively independent based on the more rigorous approach recommended by the Self-Regulatory Code of the Italian Stock Exchange (Borsa Italiana) of December 2011,<sup>47</sup> however, the 2006 version of the Self-Regulatory Code, on the basis of which the Committee in office was set up, recommended that the Remuneration Committee was to be composed of only non-executive Directors, of which “only” the majority were to be Independent Directors.

The Committee is appointed by the Board of Directors (that also indicates the Chairman) and remains in office for the Board of Directors’ entire mandate.

Three members of the Committee (Carlo Acutis, Anna Maria Artoni and Pietro Guindani) have adequate experience in financial and remuneration matters as duly assessed by the Board of Directors at the time the appointment was made.

The entire Board of Statutory Auditors has the authority to participate in the Committee’s activities.

The Remuneration Committee was composed of the following persons at the Date of the Report<sup>48</sup>:

- Carlo Acutis (Chairman);
- Anna Maria Artoni;
- Pietro Guindani;
- Luigi Roth.

The Secretary of the Board of Directors, Ms. Anna Chiara Svelto, acts as the Secretary to the Committee.

### 9.2 TASKS ASSIGNED TO THE COMMITTEE

The Committee has advisory, proposing and supervisory functions to assure the definition and application of the remuneration policies to the entire Group which are designed, on the one hand, to attract, motivate and retain the resources which have the professional qualities requested to achieve profitably the Group’s objectives and, on the other hand, are capable of aligning the management’s interests with the interests of the shareholders.

In particular, the Committee<sup>49</sup>:

- supports the Board to define the Group’s General Remuneration Policy and the respective Implementation Criteria;
- periodically assesses the adequacy, overall consistency and the effective application of the General Remuneration Policy and the Implementation Criteria;
- formulates proposals to the Board with reference to the Directors invested with special offices, the General Managers and the Executives with strategic responsibilities
  - ■ concerning their remuneration, in line with the General Remuneration Policy and with the respective Implementation Criteria;
  - ■ establishing the performance objectives related with the variable component of such remunerations;
  - ■ defining possible non-competition agreements;
  - ■ defining possible agreements to terminate the relationship also on the basis of the principles established in the General Remuneration Policy and in the respective Implementation Criteria;
- supports the Board of Directors to examine the proposals to be submitted to the Shareholders’ Meeting concerning the adoption of stock option plans based on financial instruments;
- monitors the application of the decisions adopted by the Board, in particular, verifying that the performance objectives established have actually been achieved;
- examines and submits the Annual Remuneration Statement to the Board of Directors that, by name, in the case of the members of the administration and control

<sup>47</sup> The 2011 Self-Regulatory Code (Principle 6.P.3) makes a recommendation that the members of this Committee are only to be Independent Directors or, alternatively, they are only to be Non-Executive Directors the majority of whom are to be Independent. In this case the Committee Chairman is selected from among the Independent Directors.

<sup>48</sup> Readers are referred to Table 4 for further details.

<sup>49</sup> 2011 Self-Regulatory Code Application Criterion 6.C.5.

bodies and for General Managers, and in a cumulative form in the case of Executives with strategic responsibilities:

- ■ provides an adequate representation of each of the items comprising the remuneration;
- ■ illustrates in detail the fees paid by the Company and by its subsidiaries during the reference financial year for whatever reason and in whatever form.

The Procedure for Transactions with Related Parties envisages that the respective Procedure adopted by the Company does not apply to the resolutions relating to remunerations of Directors and Executives with strategic responsibilities provided (i) the Company has adopted a remuneration policy that includes policies relating to agreements to consensually terminate the employment relationship; (ii) a Committee comprising exclusively of non-executive Directors, the majority of whom are independent was involved in defining the remuneration policy (the Remuneration Committee); (iii) a report that illustrates the remuneration policy was submitted to the advisory vote of the shareholders' meeting; (iv) the remuneration assigned is consistent with this policy. The reader is referred to the paragraph "Remuneration Policy" for further information.

As has been stated, it is important to remember that the Board of Directors assigned the Remuneration Committee the responsibilities of the Committee for Transactions with related parties envisaged by the Consob regulatory provisions for matters concerning the remuneration of Directors and Executives with strategic responsibilities.

### 9.3 OPERATION

The Committee meets whenever its Chairman deems it appropriate, or when requested by at least one member, by the Chairman of the Board of Directors or by the Managing Director, if appointed, and however, as frequently as necessary to ensure that its functions are performed correctly.

The entire Board of Statutory Auditors<sup>50</sup> participates in the Committee's meetings, as well as other representatives of the Company and/or the Group, as well as of the audit company, if deemed appropriate and at the Committee's invitation. The General Counsel and the Senior Advisor Human Resources participates in all the meetings.

Directors invested with special offices do not participate in the Remuneration Committee's meetings, in line with the recommendations of the Self-Regulatory Code<sup>51</sup> and best practices.

The Committee's meetings are convened with a notice, also sent by the Secretary, at the request of the Committee's Chairman.

The documentation and information available (and in any event the documentation and information required) are transmitted to all the Committee members sufficiently in advance to enable the members to express their opinion in the meeting.

The presence of the majority of the members in office is necessary for the Committee's meetings to be valid and the resolutions are passed with the absolute majority of the members in attendance. The Committee's meetings may also be held using telecommunication media and are duly reported under the Secretary's responsibility and transcribed in the special register<sup>52</sup>.

The Committee has adequate financial resources to perform its duties with absolute expenditure autonomy and may avail itself of external consultants when performing its functions.

The Committee has the authority<sup>53</sup> to access company information and the functions relevant to performing its duties, availing of the Secretary's support for this purpose.

<sup>50</sup> This circumstance characterizes the corporate governance rules adopted by the Company and offers the entire Board of Statutory Auditors the opportunity to directly oversee the Committee's activities and to perform more effectively the control functions assigned to it.

<sup>51</sup> 2011 Self-Regulatory Code: Application criterion 6.C.6.

<sup>52</sup> Also in accordance with the recommendations of the 2011 Self-Regulatory Code: Application Criterion 4.C.1 sub-section d).

<sup>53</sup> Also in line with the requirements of the 2011 Self-Regulatory Code: Application Criterion 4.C.1., sub-section e).

## 9.4 ACTIVITIES DURING THE FINANCIAL YEAR

The Remuneration Committee met 3 times during the 2012 financial year; the average duration was approximately one hour and thirty minutes. All the members in office attended the Committee's meetings; the tables provided at the end of this Report summarise the participations of the members at the Committee's meetings reported during the financial year.

The Committee approved the final balance proposals of the annual variable remuneration paid to the Chairman and to the Managing Director and to the Executives with strategic business responsibilities in relation to the results achieved in the previous financial year and approved the General Remuneration Policy, subsequently approved by the Board and submitted to the advisory vote by the Shareholders' Meeting convened to approve the 2012 Financial Statements.

The Committee then examined and formulated its respective proposals to the Board concerning the remuneration of the Chairman and the Deputy Chairmen, and assessed those of the Executives with strategic responsibilities and also endorsed the criteria adopted for their determination.

The Committee submitted a proposal to the Board to reorganise the remuneration structure with regard to the Chairman and the Managing Director (Mr. Marco Tronchetti Provera) (and the proposal was duly approved by the Board) with the person concerned consequently waiving a significant part of the fixed annual gross fee (approximately 20%) established for the offices held and attributing a greater incidence to the variable components.

Furthermore, during the 2012 financial year (as also illustrated in the Remuneration Report referred to the 2012 financial year) the Committee considered launching

a "new" Industrial Business Plan for the 2012/2014 three-year period with objectives which are significantly more challenging compared to the already demanding objectives contained in the 2011/2012 Industrial Business Plan and approved the proposal (a proposal that was then approved by the Board of Directors) to anticipate the closure of the 2011-2013 LTI Plan and proposing the concurrent launch of a "new" LTI Plan extended to all the management linked to the objectives of the "new" Industrial Business Plan (for further details the reader is referred to the 2012 Remuneration Report available on the Pirelli Internet website)

The Committee developed its analysis by availing of leading consulting firms in the field of executive compensation (Towers Watson and Hay Group). The analysis was developed taking into account data published by Italian and international industrial Groups deemed to be comparable in terms of organisational structure and/or industrial sector and/or capitalisation.

Lastly, the Committee approved the proposal concerning the closure agreement following the resignation of Francesco Gori from the position as General Manager and Managing Director of Pirelli Tyre presented on May 10, 2012

The Committee met 2 times in the early months of the 2013 financial year.

## 10. REMUNERATION POLICY

Pirelli has already defined a Remuneration Policy, starting from the 2011 financial year, one year earlier compared to the legal obligation and has submitted the Policy to an advisory vote by the shareholders.

Pirelli's aim, in terms of the human resources policy, is to attract, motivate and retain the resources which have the professional qualities required to achieve profitably the Group's objectives.

The Remuneration Policy is designed to achieve this objective. The Policy is defined so as to align the Management's interests with those of the shareholders, pursuing the priority objective of creating sustainable value in the medium-long term, by creating a strong link between remuneration, on the one hand, and individual performance and the Group's performance, on the other hand.

The Policy's definition is the result of a clear and transparent process in which a central role was played by the Remuneration Committee and by the Board of Directors.

In this regard, it is important to note that the Report on Re-

muneration updated for the 2013 financial year will be submitted to the Company's Shareholders' Meeting (the Report contains the Remuneration Policy referred to the 2013 financial year and the Statement on Remuneration referred to the 2012 financial year). The Report on Remuneration referred to the 2013 financial year will be made available on the Pirelli Internet website no later than 21 days prior to the Shareholders' Meeting scheduled for May 13, 2013 and the Report will be submitted to the Meeting for consultation.

## 11. COMMITTEE FOR INTERNAL CONTROL, RISKS AND CORPORATE GOVERNANCE

### 11.1 COMPOSITION

The Corporate Governance System adopted by Pirelli & C. S.p.A. (hereafter, "Pirelli & C." or the "Company") from 2000, envisages setting up a Committee for Internal Control and Corporate Governance (hereafter, the "Committee"), in 2009 this Committee was renamed "Committee for Internal Control, Risks and Corporate Governance". The Committee has advisory and proposing functions and its mission is to assure the efficiency, effectiveness and correctness of the internal control system, on the one hand, and the corporate governance structure, in general, on the other hand, based on an appropriate preparatory activity in relation to the risk management system. The Committee is composed of four members, following the death of Prof. Paolo Ferro-Luzzi and at the Date of the Report, these members are exclusively independent based on the more rigorous approach, as recommended by the "new" Self-Disciplinary Code of the Italian Stock Exchange (Borsa Italiana) of December 2011<sup>54</sup>, how-

ever, the 2006 version of the Self-Disciplinary Code, on the basis of which the Committee in office was set up, recommended that this Committee was to be composed only of non-executive Directors, of which "only" the majority were to be Independent Directors.

The Committee is appointed by the Board of Directors (that also indicates the Chairman) and remains in office for the duration of the Board of Directors' entire mandate.

Two members of the Committee (Carlo Secchi and Franco Bruni) have adequate experience in accounting and finance matters, as assessed by the Board of Directors at the date the appointment was made.

The Committee for Internal Control, Risks and Corporate Governance was composed as follows at the Date of the Report:

- Carlo Secchi (Chairman);
- Franco Bruni;
- Elisabetta Magistretti;
- Luigi Roth.

The Secretary of the Board of Directors, Ms. Anna Chiara Svelto acts as the Secretary to the Committee.

The entire Board of Statutory Auditors has the authority to participate in the Committee's activities.

### 11.2 TASKS ASSIGNED TO THE COMMITTEE

The Board of Directors was convened on April 21, 2011 and confirmed the tasks – of a fact-finding and advisory nature – originally assigned to the Committee for Internal Control and Corporate Governance, moreover, in line with the tasks indicated in the Self-Regulatory Code and also confirmed the corporate governance prerogatives which have characterised the Committee since it was established.

In particular, the Committee for Internal Control, Risks and Corporate Governance:

- assists the Board of Directors:
  - (i) in defining the policy guidelines for the internal control system and risk management, so that the main risks concerning the Company and its subsidiaries are identified correctly and adequately measured, managed and monitored; (ii) in determining the degree of compatibility of these risks to assure a business management that is consistent with the

<sup>54</sup> The 2011 Self-Regulatory Code (Principle 7.P4) makes a recommendation that the members of this Committee are only to be Independent Directors or, alternatively, they are only to be Non-Executive Directors the majority of whom are to be Independent. In this case the Committee Chairman is selected from among the Independent Directors.



strategic objectives identified. Following the Company's approval of a new risk management and supervision model, the Committee was assigned advisory and/or proposing tasks in relation to the new risk assessment and risk management model, in this regard the reader is referred to the paragraph "Risk governance system".

- ■ in identifying an Executive Director appointed to supervise the operations of the internal control system and risk management in relation to the Company's characteristics and risk profile;
- ■ in assessing the adequacy, efficiency and the effective operation of the internal control system at least once a year;
- ■ in describing the essential aspects of the internal control system in the corporate governance report, expressing its assessment concerning the system's overall accuracy;
- expresses an opinion on the proposals relating to the appointment, revocation, task assignment and remuneration of the officer responsible for the Internal Audit function and assures that the officer obtains suitable resources to fulfil its functions;
- assesses (a) the correct use of the accounting standards and their consistent application within the Group together with the Board of Statutory Auditors, the Company's administration Managers, the Responsible Officer and the auditors, for the purposes of preparing the Consolidated Financial Statements, (b) the possible letter issued by the statutory auditor outlining suggestions for the Company's management and the possible report concerning the key questions which emerged during the statutory audit;

- expresses opinions concerning specific aspects relating to the identification of the principal company risks, at the request of the designated Director, as well as the design, implementation and management of the internal control system;
- examines the audit plan prepared by the Internal Audit Manager, as well as the periodic reports prepared thereby;
- assesses the "Compliance Plan" once a year and the consequent report on the activities performed;
- reports to the Board of Directors on the activity performed and the adequacy of the internal control system, at least at the time the Financial Statements and the interim report are to be approved;
- supervises compliance with and the periodic update of the corporate governance rules and compliance with the rules of conduct which may be adopted by the Company and its subsidiaries. In particular, the Committee is also responsible for proposing the procedures and the timing for the Board of Directors to perform the annual self-evaluation;
- performs the additional tasks assigned to it by the Board of Directors, also in relation to supervising the procedural correctness and the substantial fairness of the operations.

As has been stated the Board of Directors then assigned the responsibilities of the Committee for Operations with Related Parties envisaged by the Consob regulatory requirements to the Committee for Internal Control, Risks and Corporate Governance, with the sole exception of issues concerning the remuneration of Directors and Executives with strategic responsibilities which are entrusted to the Remuneration Committee.

### 11.3 OPERATION

The Committee meets whenever its Chairman deems it appropriate, or whenever a request is made by at least one Committee Member, or by the Chairman of the Board of Directors or by the Managing Director, if appointed, and however, as often as appropriate to ensure that its functions are performed correctly.

The Secretary of the Board of Directors acts as the Secretary to the Committee.

The General Counsel and the Internal Audit Director, the Risk Officer, the Responsible Officer, as well as additional representatives of the Company and/or Group attend the

IT HAS BEEN A REALLY INTERESTING EXPERIENCE TO READ ALL THE DESCRIPTIONS THAT STUDENTS FROM ALL OVER THE WORLD CAME UP WITH ABOUT THE VALUES OF OUR FUTURE. IT WAS VERY HARD TO MAKE A CHOICE BUT SINCE I COULD ONLY CHOOSE 10 I FOCUSSED ON VALUES THAT ARE CONNECTED WITH WHAT I KNOW: FORMULA ONE. THAT'S WHY I CHOSE CONTRIBUTIONS LIKE FLEXIBILITY, IMPROVEMENT AND INNOVATION. MY PERSONAL WINNER BY A LONG WAY THOUGH IS 'HONESTY'. JUST LIKE THE STUDENT WHO WROTE IT, I BELIEVE THAT HONESTY IS ALWAYS THE BEST POLICY AND IT WILL TAKE YOU A LONG WAY IN BOTH YOUR PROFESSIONAL AND PERSONAL LIFE. **SEBASTIAN VETTEL**

Committee's meetings concerning specific matters when deemed appropriate by the Committee and the representatives of the Audit Company are invited to attend when issues concerning the statutory audit of the accounts are discussed.

The Internal Audit Manager (who reports to the Committee for Internal Control, Risks and Corporate Governance and to the Board of Statutory Auditors) reports on his activities on a quarterly basis and presents an annual Audit Plan.

In addition, the Responsible Officer reports on the activities performed at least once a year.

The entire Board of Statutory Auditors has the authority to participate in the Committee's activities.

The Committee's meetings are convenient by a notice, also sent by the Secretary, at the request of the Committee's Chairman. The documentation and information available (and in any event the documentation and information required) are transmitted for the Committee members sufficiently in advance to enable the members to express their opinion in the meeting.

The presence of the majority of the members in office is required for the Committee's meetings to be valid and the resolutions are passed with the absolute majority of the members in attendance. The Committee's meetings may also be held using telecommunication media and are duly reported under the Secretary's responsibility and transcribed in the special register<sup>55</sup>.

The Committee has adequate financial resources to perform its duties with absolute expenditure autonomy and may avail itself of external consultants when performing its functions.

The Committee has the authority to access company information and the functions relevant to performing its duties, availing of the Secretary's support for this purpose<sup>56</sup>.

## 11.4 ACTIVITIES DURING THE FINANCIAL YEAR

The Committee for Internal Control, Risks and Corporate Governance met 12 times during 2012 with an average participation of its members exceeding 85%. The average duration of the meetings exceeded 2 hours.

The Committee met 5 times during the 2013 financial year up to the Date of the Report.

### ACTIVITIES RELATING TO CORPORATE GOVERNANCE

The Committee made a real contribution to the process of implementing and constantly updating the corporate governance tools of the Company and of the Group.

During the 2012 financial year, the Committee approved the proposal (the proposal was later approved by the Board of Directors) to extend, for internal purposes, the obligations set out in the insider dealing discipline and the self-regulatory disciplines relating to the so-called black-out periods to all the members of the Management Committee and to the Directors of the subsidiary Pirelli Tyre.

The Committee approved the proposal to redetermine the quantitative limit of significance used in order to assess the existence of objective evidence that the financial assets defined as "available for sale" have been impaired (or not). In particular, the quantitative limit was redetermined from 1/3 to 50% in the case of securities referring to the banking sector, in view of the exceptional increase in volatility of this sector. The revised threshold was obtained from the updated historical analysis performed in 2008 and only reflects the adjustments of the new background conditions. In fact, the significant increase in volatility of the financial markets, and in particular, of the banking sector determined the presence of exceptional circumstances for which it became necessary to review the quantitative threshold to define the long-term impairment with reference to securities relating to this sector. Whereas, the criterion to define the "long-term" impairment timing threshold (12 months) was not changed.

The Committee approved the proposal to avail of the right granted to Italian listed companies, namely, the right to depart from the obligation to disclose information docu-

<sup>55</sup> Also in line with the requirements of the Self-Regulatory Code Application Criterion 4.C., sub-section d).

<sup>56</sup> 2011 Self-Regulatory Code Application Criterion 4.C.1., sub-section e).

ments (so-called opt-out) - as envisaged under Article 70 and Article 71 of the Issuers' Regulations - prescribed at the time of significant merger, spin-off, capital increase transactions by conferring assets in kind, acquisitions and transfers which exceed the threshold envisaged by the Issuers' Regulations, except for the choice of proceeding to publish, from time to time, an information document with reference to a specific transaction, even regardless of its economic value.

During the 2012 financial year, the Committee examined the results of the 2011 Board performance evaluation and initiated the self-assessment process referred to the 2012 financial year, examining the results during 2013. The reader is referred to the respective section with regard to the latter point.

Again, with reference to "corporate governance" the Committee managed the investigation concerning the existence of the independence requirements of Directors and compliance with the Policy concerning the Maximum number of appointments deemed to be compatible with the position of a Director of Pirelli, the results of which are detailed in the following paragraphs: "Independent Directors" and "Maximum number of positions held in other companies".

The Committee approved in advance a number of changes to the Company's Organisational Model 231, for further details in this regard the reader is referred to the section on the Code of Ethics, Policies and Organisational Model 231.

The Committee expressed its assessment on the activities performed by the Internal Audit management in order to acknowledge the 2011 variable incentive and expressed an opinion in relation to the 2012 incentive scheme, establishing a significant incidence of the qualitative targets to be assessed by the Committee.

Lastly, the Committee submitted the Half-Yearly Corporate Governance Report to the Board for approval, published as a single document together with the Half-Yearly Financial Report as of June 30, 2012.

The Committee also shared the proposals regarding the amendments to the Company Bylaws that will be submitted before the Shareholders' Meeting of 13 May 2013.

### ACTIVITIES RELATING TO INTERNAL CONTROL

The Committee approved the final results of the activities performed to implement the annual Audit Plan and approved the Audit Plan for the next financial year. The Committee focused on the analysis of the structure and the operation of the Internal Audit Function, and in particular, the procedures to set out the 2012 Audit Plan, in this regard the reader is referred to the "Internal Control System" section.

The Committee constantly monitored the work performed by the Internal Audit Department and the implementation of the plans of action concerning the corrective measures required to assure an on-going improvement of the system and periodically examined the report of the activities performed.

The Committee met with the Responsible Officer at the start of the 2012 financial year, and the Responsible Officer reported on the suitability of the means and the powers attributed, as well as on the activities performed in relation to the Financial Statements for the year ended December 31, 2011, a similar activity was performed during 2013 in relation to the Financial Statements as of December 31, 2012. In addition, the Committee:

- endorsed the procedure and the results of the so-called impairment test;
- examined and positively evaluated the Audit Plan referred to the 2012 financial year submitted by the audit company Reconta Ernst & Young;
- focused on a number of issues concerning the application of the accounting standards, together with the audit company and the Responsible Officer, in particular, with reference to the treatment of shareholdings in associate companies;
- was informed of the periodic meetings between the Board of Statutory Auditors and the Audit Company which did not reveal any significant situations and/or information;

The Committee expressed a preliminary favourable opinion in relation to several operations of minor significance performed by the Company or by its subsidiaries with related parties.

The Committee has also examined and constantly monitored the negotiations relating to the transaction (with a related party) intended to enhance the equity and financial position, as well as to relaunch the industrial prospects of Prelios S.p.A. to be implemented by recapitalising the Company and restructuring the financial debt (in this regard, the reader is referred to the information document concerning the transaction published on the Pirelli Internet Website).

The Committee received a periodic information flow concerning the execution status of the transactions with related parties of lesser significance authorised by the Committee. The Committee examined the outcome of an anti-corruption project initiated with the aim of assessing the aspect of corporate liability for crimes of corruption, in order to establish specific controls, if applicable, in relation to areas deemed to be potentially open to a risk of corruption<sup>57</sup> for the main countries in which Pirelli operates<sup>58</sup>. The project was structured on the basis of the following phases: (i) mapping the regulatory framework; (ii) analysing the risk profiles based on the perceived risk obtained by combining the Perceived Level of Corruption (associated with the 2011 Corruption Perception Index indicator calculated by Transparency International) with the management's assessment concerning the level of risk of each country; the control/vulnerability obtained by combining the guaranteed control of the areas deemed to be potentially subject to the risk of corruption with the Country Level of Control (associated with the indicator provided by the Internal Audit Management on the Internal Control System). A

Group anti-corruption Compliance Programme is currently being defined that incorporates principles and rules, however, already adopted within Pirelli and integrated by "new" and specific provisions in order to prevent or reduce the risk of corruption, further enhancing the Group's "anti-corruption" fabric.

Lastly, the Committee confirmed its positive opinion concerning the adequacy of the internal control system and the governance system of the Company and the Group<sup>59</sup> based on the activities performed, the assessments made, the information received and the documentation examined.

As regards the letter of suggestions addressed to the Company's management in relation to the 2011 financial statements the Committee has acknowledged that the auditor will present the letter concerned to the Committee during the financial year.

## ACTIVITIES RELATING TO RISK GOVERNANCE

The Committee constantly supervised the risk assessment activity during the financial year

In particular, during the financial year the Committee performed an in-depth analysis of the risks associated with specific investment projects.

The definition of a specific analysis activity in relation to production sites, strategic units and critical IT sites was also endorsed, also with reference to some types of risk (earthquakes; floods; power blackouts) with the aim of quantifying the possible impact where one of the risk events mapped out may occur and to define specific management and risk mitigation strategies.

The Committee examined the programme initiated by the Risk Governance function to further enhance the logical and physical "safety" of corporate data.

The Committee performed an in-depth examination of alternative crisis scenarios and their possible impacts on the Company's Industrial Plan and possible mitigation actions and was kept informed regarding the implementation of the plans to enhance the safety mechanisms (physical, logical and infrastructural) of the Group's main IT systems

<sup>57</sup> Intermediaries; relations with the Public Administration and Trade Unions; business transactions (purchase/sale); gifts, travelling, entertainment or business expenses; sponsorships and promotional activities; charitable activities; financing political parties/politicians; human resources; petty cash; facilitation payments.

<sup>58</sup> Argentina, Brazil, China, Egypt, France, Germany, Luxembourg, United Kingdom, Romania, Russia, Spain, United States, Switzerland, Turkey, Venezuela.

<sup>59</sup> Refer to the section "Role of the Board of Directors" and the paragraph "Internal control and governance system".

and examined in detail the risk issues concerning the supply chain. The analysis involved 70% (in terms of cost) of the raw materials used by Pirelli and the respective suppliers and provided the Group with mitigation actions designed to reduce the vulnerability of the supply chain (for example: extending the portfolio of approved production facilities per individual supplier, approving alternative materials/suppliers, increased levels of safety stock concerning critical materials, auditing suppliers).

Lastly, the Committee endorsed the new governance model for the risk governance system.

As has been stated, the reader is referred to the “Risk Governance System” section for further details.

## 12. MANAGERIAL COMMITTEES

The Group has set up specific managerial committees composed of the Group’s top and senior management with the task of assisting the Board of Directors and the Executive Directors to define the guidelines for the business activities and to implement the policies established by the Board. In particular, the following principal Managerial Committees have been established.

### MANAGEMENT COMMITTEE

The Management Committee includes all the Managers of the Business Units, Regions and Departments who report directly to the Chairman and the Managing Director.

The Management Committee is chaired by the Chairman of the Board of Directors and the Managing Director and has the task of supporting the latter in preparing the Group’s strategic guidelines to be submitted to the Board’s examination and to execute and implement the decisions taken by the

Board of Directors in this regard, and to monitor their implementation.

The Management Committee meets once a month to verify constantly the Group’s economic performance; the development of the programmes, plans and initiatives common to the Group and the Business Units or Regions which have joint importance.

### THE RISK MANAGEMENT COMMITTEE

The review of the risk model led to identifying three risk macro families, namely: (i) external environment risks, (ii) strategic risks and (iii) operating risks which guide the risk management objectives, the control model and the governance bodies (in this regard, the reader is referred to the section: “risk governance system”).

Two Risk Management Committees were set up and both were chaired by the General Counsel:

- the Strategic Risks Committee with responsibility for risks related to strategic business choices or due to the external environment in which the Group operates;
- the Operating Risks Committee that focuses on preventing and managing risks related specifically to the organisational structure, to the Group’s processes and systems.

Both Committees have the task (i) of adopting and promoting a systematic and structured process to identify and measure risks; (ii) to examine information on internal and external, existing and future risks to which the Group is exposed; (iii) to propose strategies to respond to the risk based on the overall and precise exposure to the different risk categories; (iv) to propose the implementation of a risk policy to assure that the risk is reduced to “acceptable” levels; (v) to monitor the implementation of the defined risk response strategies and compliance with the risk policies adopted.

The Risk Management Committee met on a quarterly basis during the 2012 financial year, prior to the two Committees being set up, in order to monitor the status of the external environment risks and the potential impact of risks associated with the defined strategies while verifying that the “risk value” was consistent with the defined risk appetite and acceptable risk threshold.

With reference to the operating risks the Committee constantly monitored the implementation of the plans to enhance the safety supervision arrangements (physical, logical and infrastructural) with reference to the Group’s main information systems and performed an in-depth analysis

of the risk issues relating to the supply chain. The analysis concerned 70% (in terms of cost) of the raw materials used by Pirelli and the respective suppliers and provided the Group with mitigation actions designed to reduce the vulnerability of the supply chain (for example: extending the portfolio of approved production facilities per individual supplier, approving alternative materials/suppliers, increased levels of safety stock concerning critical materials, auditing suppliers).

## THE SUSTAINABILITY STEERING COMMITTEE

The Sustainability Steering Committee is chaired by the Chairman of the Board of Directors and is responsible for policy-making and supervising the sustainability development by formulating the sustainability plans fully integrated with the Group's industrial business plan and based on the international policies and principles applicable to this area.

The Sustainability Steering Committee includes all the functions of the "value chain" represented by the respective Group Director: Sustainability and Risk Governance, Institutional Affairs, Corporate Governance, Human Resources and Organisation, Administration and control, Product, Process, Procurement, Research & Development, Investor Relations, Environment, Health and Safety, Marketing, Media Relations.

The Steering Committee updated the three-year sustainability plan during 2012, aligning the plan with the developing international scenario and with the respective new expectations, integrating, accompanying and supporting the achievement of the Industrial Plan's strategic targets.

The Plan's principal targets are represented by process and product innovation designed to achieve the safety of persons and to protect the environment, extend-

ing Pirelli's sustainable corporate management Model to the new production facilities in Mexico, Russia and Indonesia; the commitment to transform the final customer's education referred to road safety into an effective "safety culture"; the implementation of new tools to manage and enhance the human resources employed, as well as a major investment in training, a further development of the ESG risk management Model<sup>60</sup>; increasing the financial communication to the market of socially responsible investments; performing Sustainability Audits on the chain of suppliers, focusing on the procurement of materials, goods and services to verify that they are designed, produced and used with a lower impact on natural resources compared to the average market equivalent.

Lastly, the Committee analysed the results of the 2012 assessments performed by analysts concerning the main socially responsible investment indexes. In particular, Pirelli's score prepared by the EIRIS analysts referred to the FTSE4 Good indexes corresponded to 100/100, while RobecoSAM that performs the analyses for the Dow Jones sustainability indexes, assigned Pirelli with the world sustainability Leadership award in the "Auto Parts and Tyre" sector of the Dow Jones Sustainability Stoxx and the Dow Jones Sustainability World for the sixth consecutive year, with a score corresponding to 86/100 compared to a sector average that corresponds to 53.

The reader is referred to the Sustainability Report (Volume "U" of the document "Financial Report as of 31/12/2012") for a complete description of Pirelli's sustainable performance in 2012 and the respective long-term targets.

## THE PRODUCT COMMITTEES

Three Product Committees were established in the early months of the 2012 financial year (Car Product Committee; Truck, Agro and Vehicles Product Committee; Motorcycle Product Committee) in order to assure a common strategic policy and supervision of the product development process with the involvement of the various corporate areas concerned, all three Committees were chaired by the Chairman and Managing Director.

The Committees permanently include the respective Directors of the Business Units (Car, Truck, Agro and Special Vehicles; Motorcycle); the Management Control Director; the

<sup>60</sup> ESG Risks: Environmental, social, governance risks, namely, the risks relating to the following areas: management and social, environmental impacts and governance.

Investor Relations Director; the Research and Development Director; the Quality Director; the Operations Director; the MIRS Manager and the Managers with responsibility for the single Marketing areas.

The Product Committees have the following common objectives:

- to assess the competitive position of Pirelli's current product portfolio;
- to study in detail the developments of each market segment, based on the expected technological innovation and the changing attitudes and requirements of consumers;
- to define the product roadmap over the forthcoming years (3/5) on which to focus Research and Development, Production, Logistics and commercial lines;
- to define the strategic position of each new product line, on the basis of specific technologies and the expected performance, the market entry price, the marketing and sales actions which will accompany the launch and the entire life cycle up to the decision to terminate production.

#### **BUSINESS UNIT AND REGION PERFORMANCE REVIEWS**

Performance review meetings are organised every month per single Business Unit and single Region. Based on an analysis of the economic and competitive context, these meetings render it possible:

- to assess the economic and financial results of the previous month and align the information concerning the results expected for the current month.
- to share the forecasts for the subsequent quarters up to the end of the financial year.
- to assess the proposals for key actions to assure that the plan targets are achieved.

The meetings are chaired by the Chairman

and the Managing Director and in addition to the Managers of Central Functions, the meetings are attended by the Business Unit Manager or the Region Manager undergoing the Performance Review, the Business Unit controller and the area Managers within the Business Unit or the Region who are invited according to the topics on the Agenda.

#### **ORGANISATION AND PEOPLE REVIEW COMMITTEE**

The Organisation and People Review Management Committee was established during 2011, the Committee verifies periodically the consistency of the Group's organisational structure with the growth targets and the business challenges and monitors the quality of the managerial resources and their performance and defines development programmes to support the business initiatives.

The Committee is chaired by the Chairman and Managing Director and comprises: the General Counsel, the Senior Advisor Human Resources; the Human Resources and Organisation Director and avails of the support of the Senior Advisor Strategies.

### **13. SUCCESSION PLANS<sup>61</sup>**

After being set up in April 2011 the Appointments and Succession Committee has examined the Company's processes relating to the identification, management and development of the so-called "talents" which assure the Group has a "natural" internal growth potential, over time, thereby ensuring a constant generational change.

The Committee also examined the main initiatives to develop the management's skills and expertise and the process to define the so-called "succession tables".

The Committee was able to verify the structure and implementation status of the systems which allow Pirelli (i) to monitor the key resources and to verify the existence of any persons in-house who are capable of assuming roles of greater responsibility or (ii) to define the qualifications required to fill these roles in the event of recruiting from outside the Company in the case of "emergency" changes. The Appointments and Succession Committee then appointed a specialised company forming part of a global network to support Pirelli in defining the succession plans

<sup>61</sup> The information included in this section is also provided in compliance with the Consob recommendation contained in Communication DEM/11012984 dated February 24, 2011.



for top and senior management.

Based on the outcome of the analysis performed the Committee (i) prepared a proposal for a structured succession plan for the Company's top management to be implemented in the case of urgency envisaging the roles and responsibilities of the various players involved in the process defined and (ii) prepared a proposal of the process to be followed to define the natural succession plan for the Company's top management.

It is foreseen that the Board of Directors will examine the Committee's proposals during 2013 and adopt the succession plan for the Company's top management to be implemented in the case of urgency and approve the process to be followed to define the natural succession plan of the Company's top management.

## 14. INTERNAL CONTROL SYSTEM

The Internal Control System of Pirelli & C. and of the Pirelli Group is represented by the set of structural and process factors which are able to achieve the following objectives: (i) the efficiency and effectiveness of the operating activities; (ii) the dependability of information; (iii) protecting the corporate equity and (iv) respect of and compliance with the laws and regulations to assure correct information and an adequate control structure for all the Group's activities, with particular attention focused on the areas considered potentially at risk.

The internal control system is primarily a "management" tool; since, on the one hand, the Directors have the responsibility of preparing the organisation and ensuring the organisation is adequate; on the other hand, because the internal control system enables the Directors to have full and complete visibility of the organisation, thereby being able to intervene on

the organisation concerned.

In particular, the internal control system permits monitoring of compliance with the rules and procedures which govern the performance of the Company's business activities in its various forms.

Pirelli's internal control system was developed as a direct process aimed at achieving values of substantial and procedural fairness, transparency and accountability, assuring: efficiency, transparency and traceability of transactions and, more in general, of management-related activities; dependability of the accounting and management data and financial information; compliance with the laws and regulations; protecting the Company's integrity, also to prevent fraud damaging the Company and the financial markets.

The Company's "internal control system" also means "building" an organisational structure consistent with the dimensions, nature and complexity of the activity performed, as well as with its geographic location and this entails the definition of roles and responsibilities and (consequently) the allocation of so-called powers of "representation". The responsibilities are defined within Pirelli, on the one hand, to avoid functional overlapping and, on the other hand, to avoid concentrating critical activities with a single person.

The following represent the key rules underlying the Company's internal control system: (i) separation of roles when performing the principal activities involved in individual operating processes; (ii) traceability of the choices made; (iii) management of the decision-making processes based on objective criteria

### 14.1 INTERNAL CONTROL SYSTEM DIRECTOR

The Board of Directors is responsible for the internal control system as a whole, the Board establishes the policies and verifies periodically its adequacy and effective operation. For this purpose, the Board avails itself of the Committee for Internal Control, Risks and Corporate Governance, as well as the Internal Audit Management with an appropriate level of independence and suitable means to perform the activities, which are assigned the typical functions of verifying the system's adequacy and efficiency and to propose the necessary corrective solutions, if anomalies are identified.

After its renewal, the Board identified the Chairman and Managing Director as the Director with responsibility for the internal control system in the Board of Directors' meeting held on April 21, 2011, and the tasks recommended by the

2006 version of the Self-Regulatory Code<sup>62</sup> were duly assigned. In particular, the Director with responsibility for the internal control system has the following tasks:

- to identify the principal risks to which the company is exposed, taking into account the characteristics of the activities performed by the Company that issued the report and by its subsidiaries and to submit them periodically to the Board of Directors' examination;
- to implement the policies defined by the Board of Directors, by managing the implementation and management of the internal control system and risk management and verifying constantly the adequacy and effectiveness;
- to adapt the system to the dynamics of the operating conditions and the legislative and regulatory scenario;
- to propose to the Board the appointment, revocation and remuneration of the Internal Audit function Manager.

The Director responsible for the internal control system and risk management can request the internal audit function to perform audits on specific operating areas and concerning compliance with the internal rules and procedures during the execution of corporate transactions. The Internal Audit function Manager reports to the Committee for Internal Control, Risks and Corporate Governance and to the Board of Directors regarding problems or critical situations which emerged during the performance of its activities of which it has been made aware in order to permit appropriate initiatives to be defined.

## 14.2 INTERNAL AUDIT DEPARTMENT

The Internal Audit Department (managed by Maurizio Bonzi) plays a significant role in the internal control system with the principal task of assessing the adequacy and functional operation of Pirelli's control and corporate governance processes through independent insurance and consultancy activities, also in relation to the activity performed for the subsidiaries. The Internal Audit Department's activity is performed in line with the mandate received and duly approved by the Committee for Internal Control and Corporate Governance, in compliance with international standards, in relation to the following aspects:

- mission;
- targets and responsibilities (independence, complete access to information, field of activity, disclosure of results);
- improving the quality of the internal audit activities; principles of professional conduct;
- professional reference standards.

The Internal Audit Manager reports hierarchically to the General Counsel and functionally to the Committee for Internal Control, Risks and Corporate Governance and to the Board of Statutory Auditors and at the Date of the Report the Department includes 18 persons of six different nationalities with an average of 7 years experience in the Department (excluding the Internal Audit Manager).

The Internal Audit Department operates on the basis of an annual Audit Plan approved in advance by the Committee for Internal Control, Risks and Corporate Governance.

The Audit Plan referred to the 2013 financial year envisages audits in 24 different countries, involving approximately 18 thousand hours work.

The companies and corporate departments "subject" to possible audits are identified once a year to define the Audit Plan and these are subsequently classified in relation to the need to ensure "coverage" and their respective degree of risk. The following factors are involved in defining the (risk-based) ranking: (i) the level of control identified in the previous audits performed in the specific company and/or organisational unit; (ii) the "vulnerability" factor in relation to specific assessments which take into account, by way of example, country risk, market risk, the size and organisational complexity, recent organisational changes made, the extent of any critical aspects identified, the time that has elapsed

<sup>62</sup> Also to implement the recommendations of the Self-Regulatory Code Principle 7.P.3.

since the last audit (iii) the Company's impact on the Group in relation to the consolidated data, in terms of the operational results or the invested capital, as well as (iv) the risk assessment activities performed during the previous financial year.

The 2013 Audit Plan is consistent with the objectives of the 2012/2014 Industrial Business Plan and confirms two principal emphasised topics relating to social responsibility and to the corporate quality management system; moreover, inter alia, the extension of the continuous monitoring project is foreseen during 2013, a project that was developed from 2012, as well as completion of the process to review the assessment method of the internal control system.

The Audit Plan evidently does not have a rigid structure, since the Plan can be integrated during the financial year in relation to specific control requirements.

Specific interventions were also performed on the information systems, including the accounting-related information systems, in the framework of the audit activities.

The Internal Audit Manager reports, on a quarterly basis, to the Committee for Internal Control, Risks and Corporate Governance, to the Board of Auditors and sends a report to the Board of Directors on a half-yearly basis outlining the activity performed. In particular, the Internal Audit Manager reports on the outcomes of the audits performed, compliance with the action plans defined and expresses an assessment relating to the suitability of the internal control system. Specific interventions are also performed on the information systems, including the accounting-related information systems in the framework of the audit activities.

The Internal Audit Management was subjected to the periodic External Quality Assessment during 2012, as requested by the Institute of Internal Audit (IIA), in order to assess the compliance of the activities

performed with the Standards for the Professional Practice of Internal Auditing issued by the Institute, and confirmed the result of the previous assessment of "general compliance", this assessment corresponds to the maximum score attributable in accordance with the cited standards.

The internal control system is completed by a planning and control system, structured per sector and operating unit that produces a detailed monthly report for the top management to provide the top management with a useful tool to supervise the specific activities.

Moreover, Managers with strategic business responsibilities and Managers with sector and function expertise sit on the Boards of Directors of the major subsidiaries in order to pursue the strategies and policies adopted by the Parent Company.

Furthermore, the Compliance Group Function that reports to the Legal, Corporate Affairs and Group Compliance Manager has been fully implemented, and is therefore, separate from the Internal Audit function called on to collaborate with the other group functions in order to assure the constant alignment of the internal regulations, the processes, and more in general, the business activities with the applicable regulatory framework.

The Group Compliance function, in line with best practices, has the task of assuring that the risk of non-compliance with laws, regulations, and in general, with legislation, also of a self-regulatory nature is supervised in order to prevent judicial, administrative sanctions, or significant financial losses or damage to reputation.

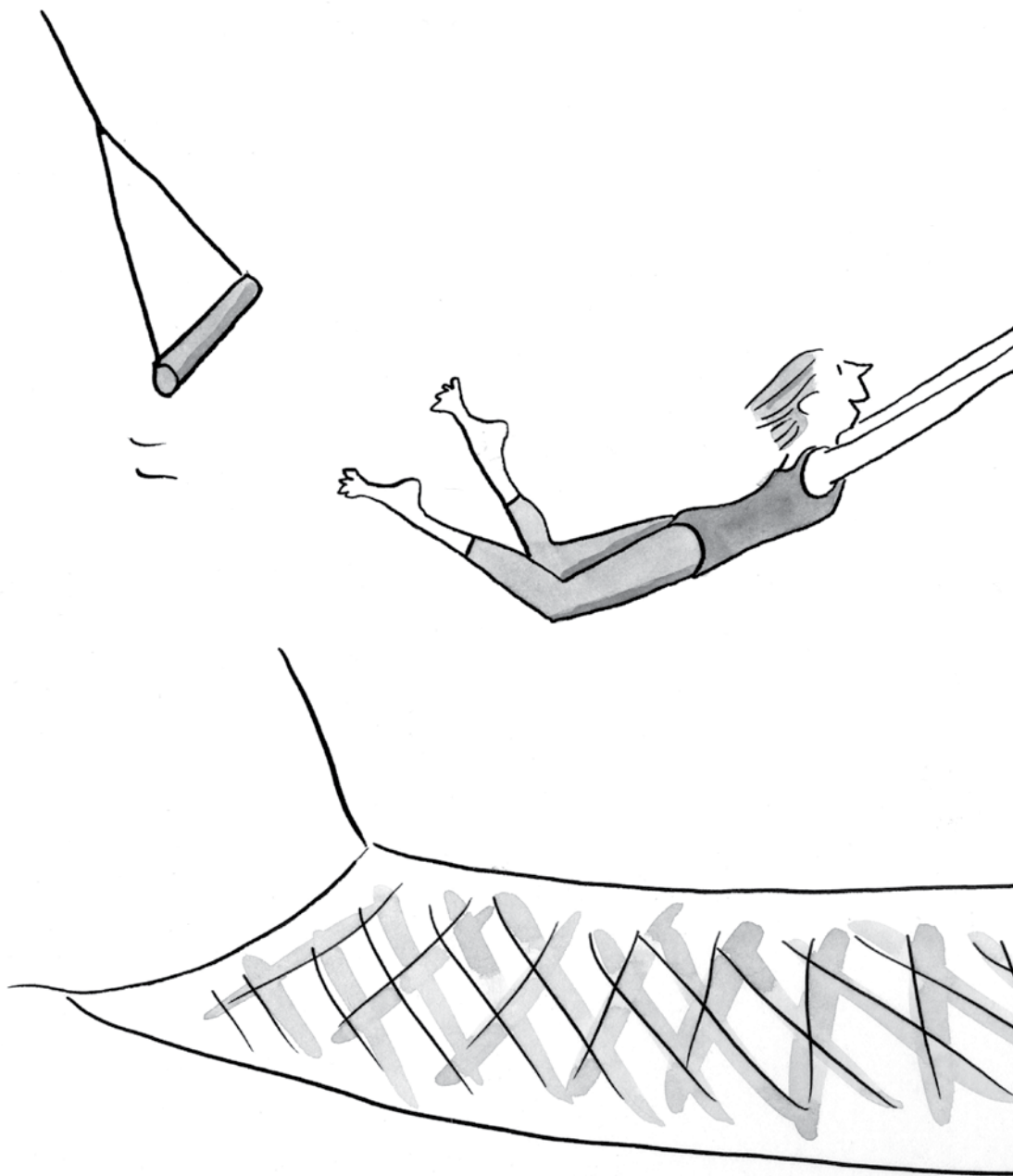
The internal control system is rendered more effective by the procedure to notify breaches, or incitement to breach laws and regulations, principles sanctioned in the Code of Ethics, internal control principles, policies, corporate rules and procedures and/or which may produce direct or indirect economic-equity damage or damage the reputation of Pirelli. The Procedure envisages the express protection against reprisals of any nature in relation to the reporting persons or employees who collaborated with the in-depth investigation to verify the grounds of the notification.

# EMPATHY SE

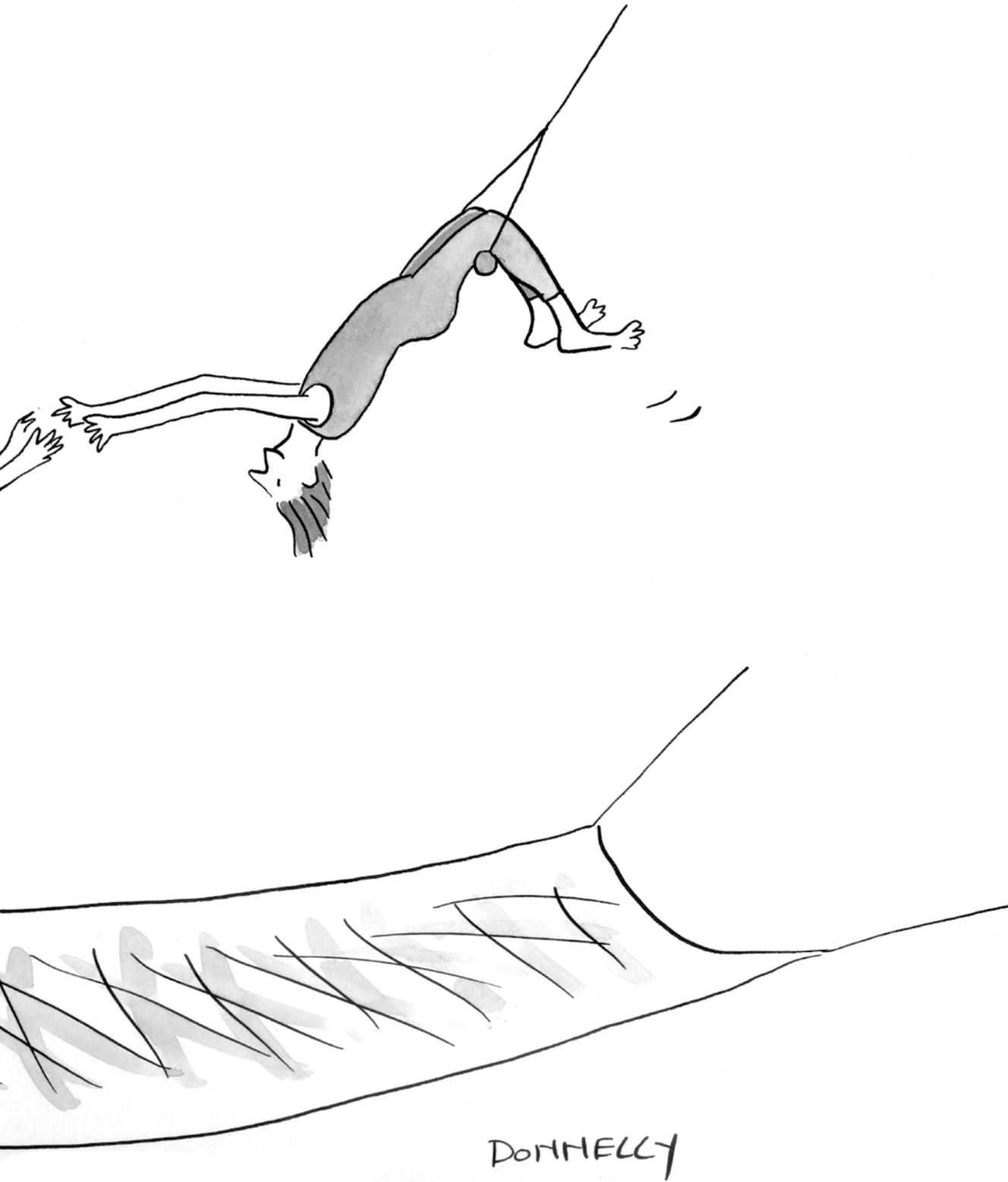
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CESS AND FAILURE TO THEIRS. WHAT I ONCE CALLED "MINE"  
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*“So you do under*



*stand my situation!”*

### 14.3. THE RISK GOVERNANCE SYSTEM

In July 2009, the Board of Directors examined and approved a new model to monitor and manage the risks which are liable to prejudice the achievement of Pirelli's strategic objectives, also in line with international best practices and with the suggestions which emerged from the self-evaluation process referred to the 2008 financial year.

The Board deemed it appropriate to adopt a structured risk management process that, on the one hand, enables the risks to be identified promptly and completely, and on the other hand, permits the adoption of adequate measures to "manage" the risks in terms of anticipating the risks and pro-active measures, rather than simply taking reactive measures, considering the accelerating pace of economic changes, the complexity of management activities and the recent changes in laws and regulations relating to corporate governance and internal control.

In particular, the Board evaluated the importance of identifying the risks before they manifest themselves and the adoption of business choices and suitable tools to avoid such risks, to reduce their impact, and more in general, "to manage them", granted that the assumption of risk represents a key component of business.

In line with this philosophy, the new integrated risk governance model (Enterprise Risk Management) has the following aims:

- "to manage" risks in terms of prevention and mitigation;
- "to seize" proactively the opportunity factors;
- to disseminate the "culture" of the value of risk within the Company, in particular, in the strategic planning and operating processes and in the most significant business choices;

- to assure transparency in relation to the risk profile assumed and the management strategies implemented, based on periodic and structured reporting to the Board of Directors and to the Top Management and adequate information to the shareholders, and more in general, to the so-called stakeholders.

In harmony with these aims, Pirelli's Enterprise Risk Management is:

- *enterprise-wide*: extended to all types of potentially significant risks/opportunities;
- *value-driven*: focused on the more significant risks/opportunities in relation to their capacity to prejudice the achievement of Pirelli's strategic objectives or to erode critical corporate assets (so-called Key Value Drivers);
- *top-down*: the Top Management identifies the priority risk areas and the events of greatest impact for the business;
- *quantitative*; where possible, based on an accurate measurement of the impacts caused by the risks on the expected economic/financial results in relation to their probable occurrence.
- *integrated* in the decision-making/business processes and, in particular, in the strategic planning and operational process. Con riferimento alla Governance del nuovo modello, è da osservare che ruolo centrale è rivestito dal Consiglio di Amministrazione.

It is important to observe that the Board of Directors plays a central role with reference to the "governance" of the new model.

Indeed, the Board is responsible for supervising the risk management process so that the risks assumed in the business are consistent with the strategies (so-called monitoring action). Furthermore, the Board defines the attitude to risk (so-called identification of the "acceptable risk threshold") and establishes the guidelines to manage the risks which may "interfere with" or prejudice achieving the business objectives or erode critical corporate assets, in line with its top management and strategic policy-making mission.

In view of the above, the Board redefined the responsibilities and composition of the Committee for Internal Control and Corporate Governance in 2009, and the Committee was renamed as follows: "Committee for Internal Control, Risks and Corporate Governance" and the Committee's composition was extended to 5 Board Members.

In particular, the Committee for Internal Control, Risks and Corporate Governance supports the Board (i) in the pe-



riodic identification and assessment of the principal risks relating to the Company and its subsidiaries, at least once a year, to ensure these risks are monitored correctly (Annual Risk Assessment) (ii) in defining the mitigation plans, and in general, the “risk governance” and updating them periodically, at least once a year (Annual Risk Management Plan) in order to maintain the overall levels of exposure to risk within the risk threshold assessed by the Board of Directors as being “acceptable” (risk appetite), based on the proposal made by the Committee concerned).

The Risk Model was reviewed during 2012, more than two years after the integrated risk governance model was introduced, and three risk macro families were considered which guide the risk management objectives, the control model and the governance bodies, as outlined below:

- **Risks associated with the external environment** in which the Company operates, the occurrence of which is outside the Company’s control. This category includes the risk areas related to the macroeconomic trends, the development of demand, the strategies adopted by competitors, technological innovations, the introduction of new legislation and the risks associated with the country (economic, safety, political and environmental). The **risk management objective** is to monitor the risk and mitigate the impact in the event the risk occurs. **The control model** is based on the adoption of internal/external tools to identify and monitor the risks, stress tests to assess the robustness of the plans, the construction of alternative scenarios to the “base” scenarios, business cases to assess the impact of significant changes to the environment conditions, etc.
- **Strategic Risks**, namely, risks characteristic of the reference business, the

correct management of which is a source of competitive edge, or otherwise, the cause of failing to achieve planned targets (three-year and annual). This category includes the risk areas associated with the market, product and process innovation, price volatility of raw materials, production processes, financial organisational risks and risks associated with M&A operations. **The risk management objective** is to manage the risk using specific tools and safeguards designed to reduce the probability or to limit the impact if the risk occurs with a view to achieving the best risk-performance scenario.

- **The control model** is based on identifying and measuring the PBIT/Cash Flow@Risk when preparing the strategic/management plans, defining the risk appetite and the risk tolerance for the main risk events, introducing Key Risk Indicators in Group reporting, monitoring the mitigation plan in relation to significant risk events in the absence of specific business safeguards which are already operational.
- **Operating Risks**, namely, risks generated by the organisational structure, by the processes and by the Group systems, where assuming these risks does not produce any competitive edge. The main risk areas in this category refer to Information Technology, Security, Business Interruption, Legal & Compliance, Health, Safety & Environment risks. **The risk management objective** is to achieve management via the prevention and internal control systems integrated in the business processes. **The control model** is based on the development of ad hoc methods to measure the risk, define mitigation and prevention plans and the continuous monitoring of their implementation.

The Board of Directors is supported by two Risk Management Committees in relation to the various risk macro families, each Management Committee has specific areas of responsibility.

The Strategic Risks Committee (is chaired by the General Counsel) and is composed of: the Chief Operating Officer, the Chief Technical Officer; the Administration and Finance Manager; the Planning and Control Manager; the Director of Purchasing; the Industrial and Motorcycle Business Unit Managers, the Investor Relations Manager, the Human Resources and Organisation Manager, Supply Chain, Operations, Senior Advisor Human Resources, Senior Advisor Strategies, Sustainability and Risk Governance

Manager) with expertise and responsibility for the risks related to the strategic business choices, or due to the external environment in which the Group operates. The Operating Risks Committee (is chaired by the General Counsel and is composed of: the Chief Technical Officer, the Internal Audit Manager, the Legal and Corporate Affairs Manager, the Information & Communication Technology Manager, Supply Chain, Operations, Financial and Business Continuity Risk Management, the Director of Purchasing, Security, Industrial Relations, Health and Safety & Environment, the Sustainability and Risk Governance Manager) and focuses on preventing and managing the risks specifically related to the organisational structure, the processes and Group's systems.

The two Risk Management Committees have the following responsibilities (i) to adopt and promote a systematic and structured process to identify and measure the risks; (ii) to examine the information concerning internal and external, existing and future risks to which the Group is exposed; (iii) to propose strategies to respond to the risk in relation to the overall and detailed exposure to the various categories of risks; (iv) to propose the implementation of a risk policy in order to guarantee that the risk is reduced to "acceptable" levels; (v) to monitor the implementation of the strategies adopted in response to the risk defined and compliance with the risk policies adopted.

The Management Committees avail of the Sustainability and Risk Governance Department (managed by Filippo Bettini) that includes the Risk Officer (Ms. Alessia Carnevale) who coordinates the assessment process and guarantees the on-going monitoring of the Company's and the Group's exposure to the principal risks, while monitoring the effective implementation of the mitigation plans in the indi-

vidual company departments and organisational units. Pirelli's Enterprise Risk Management model forms part of three key phases in the decision-making process:

- strategic planning (medium/long term);
- operational planning (annual and quarterly);
- new investment projects.

### *Risk analysis in strategic planning*

Risk analysis and risk measurement accompany the medium/long term planning process that is concluded with the presentation of the three-year plan to the investors.

The methodology adopted is structured into three macro-phases:

- identification of priority risk events;
- risk analysis;
- risk management.

The Strategic Risks Committee defines the risk analysis methods and establishes the metrics to measure the risk events, in particular:

- the economic and financial reference parameters to measure the risks and their impacts (PBIT, Cash Flow);
- the probability scales;
- the references to assess the maturity level of the existing risk management systems (referred to the level of protection from risk in relation to the existence of management and control procedures/processes, monitoring/reporting tools and the responsibility and "ownership" of the defined risk).

The identification of the priority risk areas and the respective assessment in terms of the potential impact and the probability of occurrence are guided by the Region based on the objectives and the business plan's strategic guidelines (key value driver). The central functions coordinate the analysis of the risks which are monitored centrally, for example: raw materials and exchange rates; statistical inference techniques are applied to some risk events which are especially significant for Pirelli to build possible development scenarios as an alternative to the scenarios considered when the industrial plan was defined in order to evaluate the "strength" of its assumptions and the possible impacts on the expected results.

The use of quantitative metrics to measure the impact permits an aggregation of the risks and a representation of the Group's overall exposure to risk (so-called Profit@Risk).

The Strategic Risks Committee assures that the following

aspects are defined in relation to the so-called Profit@risk:

- the target levels of exposure to priority risks;
- the risk management strategies, in line with the existing risk appetite (transfer, reduce, eliminate, mitigate the risk);
- the plans of action and the “management” policies to maintain the levels of exposure within the “target” limits.

The Board of Directors takes into account the quantified risks and opportunities during the phase to approve the plan and verifies that the volatility of the economic and financial results falls within the defined tolerance threshold.

The causes of risk and the existing risk management structure are analysed in relation to the most significant risk events, in terms of the following aspects:

- risk management strategies, policies and processes;
- organisational protections;
- supporting monitoring/reporting tools and information systems in order to define targeted risk mitigation plans.

The three-year plan targets and the strategic choices which the plan reflects are also submitted to “stress tests” to verify the Group’s economic, financial and equity “capacity” at the occurrence of uncertainty phenomena which cannot be readily “weighed” using probabilistic factors.

The Group’s overall exposure to priority risks and the respective mitigation strategies and actions are contained in the Annual Risk Assessment and Management Plan. The Risk Officer assures the implementation of the agreed mitigation plans and the on-going monitoring of the exposure to priority risks and the Risk Officer can also propose a redefinition of the current recovery plans (if they are inadequate) and an analysis of any possible emerging risks.

### *Risk analysis in the annual and quarterly operational planning*

The high volatility of the principal economic and financial variables (price of raw materials, exchange rates, trend of reference markets, pricing trend) has entailed supplementing the “traditional” reporting tools with a quarterly measurement of the volatility of the expected profit in relation to the risk events or opportunities which may produce a change compared to the targets or the best renewed forecasts.

The profit@risk review is subject to a quarterly report to the Top Management and supports the Top Management in the timely identification of the market trends and a possible “realignment” of the strategic actions.

The review is submitted to the Committee for Internal Control and Corporate Governance during the year.

### *Risk analysis in investment projects*

Pirelli’s risk model was developed further during 2011, becoming a support tool in the decision-making process relating to investment initiatives.

The set of characteristic information for the traditional analysis of investment projects was supplemented with the “risk dimension” based on:

- a detailed analysis of the economic, political, safety and operational risk of the country where the investment is intended to be made;
- the estimate of the “risk adjusted” cash profiles generated by the investment and the **degree of volatility of the Net Present Value (NPV@risk)** in relation to the events which are able to generate changes to the business plan results.

The inclusion of the risk variable in the analysis of investment projects and the possibility of comparing them with the expected returns, will contribute to

- enhance further the Top Management’s awareness and guide the **risk management strategies**;
- permit a **comparative evaluation** of the investment initiatives to be made.

**The analysis of operating risks** forms an integral part of the Group’s internal control system; ad hoc methods are developed for each risk area with the aim of identifying the vulnerabilities of the control systems and the possible impacts for the Group.

At present the analysis has concerned business inter-

ruption risks, risks associated with information systems, risks relating to the supply chain and corporate criminal liability risks. The areas of vulnerability which emerged are subject to a continuous follow-up activity performed by the Operating Risks Committee.

#### 14.3.1 “RISK MANAGEMENT AND INTERNAL CONTROL SYSTEM IN RELATION TO THE FINANCIAL REPORTING PROCESS”

The Company has implemented a specific and structured risk management and internal control system supported by a dedicated IT application, in relation to the process to prepare the separate and consolidated half-yearly and annual financial reports.

In general, the internal control system implemented by the Company is designed to assure the protection of the Company’s assets, compliance with the laws and regulations, the efficiency and effectiveness of the Company’s operations in addition to the dependability, accuracy and timeliness of the financial reporting.

In particular, the process to prepare the financial reports is based on adequate administrative and accounting procedures, performed in compliance with the criteria established by the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organisations of Trade-way Commission.

The administrative and accounting procedures involved to prepare the Financial Statements and every other financial communication are prepared under the responsibility of the Responsible Officer assigned to prepare the corporate and accounting documents (Francesco Tanzi), who, together with the Chairman of the Board of Directors certifies their adequacy and effective application at the time of the annual and consolidated Financial State-

ments and the half-yearly financial report.

The significant Companies and Processes which supply and generate economic, equity or financial information have been mapped out to permit certification by the Responsible Officer. The significant Group Companies and Processes are identified annually on the basis of quantitative and qualitative criteria. The quantitative criteria consist in identifying the Group Companies which represent a higher aggregate value at a given materiality threshold in relation to the selected processes.

The qualitative criteria consist in an examination of the processes and companies which may present potential areas of risk, even though they do not meet the quantitative parameters described above, based on the assessment performed by the Chief Executive Officers and by the Chief Financial Officer of the business sectors involved.

The control risks and targets associated with preparing the Financial Statements and the respective information and the effectiveness and efficiency of the internal control system, in general, were identified for each process selected. Precise audit activities were identified and specific responsibilities were assigned for each control objective.

A system to supervise the controls performed was implemented based on a mechanism involving a chain of certifications; any critical situations which may emerge in the evaluation process become the subject of plans of action for which implementation is verified in the subsequent year-end activities.

Lastly, a procedure has been envisaged in which, once every quarter, the Chief Executive Officers and the Chief Financial Officer of the subsidiary companies issue a declaration of reliability and accuracy of the data transmitted for the purposes of preparing the Group’s consolidated Financial Statements.

The results of the audit activities are discussed by the Chief Financial Officers of the respective Sectors with the Responsible Officer prior to the date of the Board of Directors’ meetings which approve the consolidated data as of 30 June and 31 December.

In essence, a system of on-going and systematic controls has been adopted that provides a reasonable degree of certainty regarding the dependability of the information and the economic and financial reporting.

The Internal Audit Department performs periodic audits to determine the adequacy of the design and operation of the controls on companies and processes chosen randomly, se-

lected on the basis of materiality criteria. On the basis of the periodic reports the Responsible Officer reported on the System's efficiency to the Board of Directors through the Committee for Internal Control, Risks and Corporate Governance. Moreover, the same Officer, together with the Chairman of the Board of Directors provided the certification envisaged under Article 154-bis, paragraph 5 of the Unified Finance Law (TUF).

#### 14.4 CODE OF ETHICS – POLICIES AND ORGANISATIONAL MODEL 231

The internal control system described above is completed by:

- the Group's Code of Ethics;
- the Group's Policies;
- Organisational Model 231.

The Code of Ethics sets out the general principles which form the reference framework to perform and conduct business within Pirelli; the Code of Ethics indicates the targets and the values underlying the Company's business activities. Indeed, Pirelli performs its internal and external business activities based on compliance with the Code of Ethics in the belief that business success cannot be separated from business ethics.

The Directors, Statutory Auditors, Executives and employees of the Pirelli Group, and in general, everyone who operates on behalf of Pirelli, or has business relations with Pirelli are required to comply with the principles and provisions contained in this Code, each in the context of their own functions and responsibilities.

In particular, the Policies contain the "operative" statement of the principles contained in the Code of Ethics and establish rules for the entire Group designed to prevent the creation of an environment that is favourable to committing offences in general.

The Code of Ethics and the Policies have been translated in all the languages in use within the Pirelli Group (22 different languages).

The Organisational Model 231 approved by the Board of Directors on July 31, 2003 was subsequently revised and updated following changes in the laws and regulations. The Organisational Model endeavours to assure the fine tuning of a system that is based on the specific requirements arising from the coming into force of Legislative Decree No. 231/2001 concerning companies' administrative liability for the offences committed by their employees and is based on a structured pyramidal system of principles and procedures which can be outlined as follows, starting from the base:

- the Group's Code of Ethics, which have already been described;
- the general internal control principles, which characterise the Internal Control System and of which the field of application extends continuously throughout the different organisational levels;
- the Policies, which have already been described;
- Internal Control schemes, which list the principal phases of each high and medium risk operative process and the specific control activities referred to the instrumental processes, aimed at achieving a reasonable prevention of the risk of committing offences, as well as special information flows to the Supervisory Body to highlight situations of possible non-compliance with the procedures established in the organisational model.

A summary of the organisational model's guidelines is available on the Pirelli Internet website.

##### **14.4.1 THE SUPERVISORY BODY**

A special Supervisory Body oversees the operation and compliance with the model, the Supervisory Body is economically independent and is composed of the Board Member Carlo Secchi, the Lead Independent Director and the Chairman of the Committee for Internal Control, Risks and Corporate Governance, the Statutory Auditor Antonella Carù (who substituted Prof. Paolo Domenico Sfameni after he resigned from the office of Company Auditor) and the Internal Audit Manager Maurizio Bonzi.

This structure assures that the Supervisory Body is completely autonomous and independent, as well as having the presence of the various professional skills which contribute

to control the Company's management.

The Supervisory Body is also responsible for ensuring that the Board of Directors implements all the necessary changes to the Organisational Model to incorporate the changes in legislation, the methods of performance and the type of business activities. On the other hand, the Supervisory Body reports of the Board of Directors, to the Committee for Internal Control, Risks and Corporate Governance and to the Board of Statutory Auditors in relation to the verification activities performed and their outcome.

Each member of the Supervisory Body is paid an annual fee of 25 thousand euro.

The Supervisory Body was appointed by the Board of Directors on April 21, 2011, and falls from office at the same time as the Board of Directors that appointed it. With reference to the other Italian Group companies, the Supervisory Body was identified by searching for the technical and operative solution that was suited to the size and organisational context of each company, while complying with the mandate and the powers reserved to it by legislation.

Lastly, the introduction of a disciplinary system has been envisaged to sanction any non-compliance with the measures indicated in the organisation, management and control models.

Finally, it is important to note that when requested by the Supervisory Bodies of the Group Companies, the Internal Audit Department of Pirelli & C. and the Group Compliance Department provide the operational support to manage and analyse the information flows established, in accordance with Article 6, paragraph 2, sub-section d) of Legislative Decree No. 231/2001, as well as to perform specific audits based on the information received via the above-mentioned information flows.

## 14.5 AUDITING COMPANY

The statutory audit is performed by a company appointed by the Shareholders' Meeting and selected from among the registered companies.

Reconta Ernst & Young S.p.A.<sup>63</sup> was appointed to audit the annual Financial Statements, the consolidated Financial Statements and the abridged half-yearly Financial Statements referred to the 2008 – 2016 financial years. As provided for by law, the appointment was made based on the motivated proposal by the Board of Statutory Auditors that had performed an in-depth technical and economic evaluation analysis. The evaluation was performed on the basis of a comparative and overall analysis of the proposals received, with particular reference to the comparison of (i) the costs and the terms and conditions of the mandate; (ii) the mix of the staff employed; (iii) the coverage of the territory, the expertise and the specific experience and (iv) the fees proposed for the same perimeter.

The Reconta Ernst & Young S.p.A. audit company is the Italian organisation in the Ernst & Young network that was also appointed to audit the Financial Statements of the principal companies of the Pirelli Group, through the organisations present in the various countries in which Pirelli operates. Pietro Carena is the person in Pirelli & C. S.p.A. who is responsible for auditing the accounts.

The auditing company is required to verify the preparation of the report on corporate governance and the structure of share ownership, as well as to express the so-called "opinion on consistency" referred to some information disclosed in this Report.

Once a year the auditing company defines a plan of activities that is notified to the Committee for Internal Control, Risks and Corporate Governance.

The fees paid to Reconta Ernst & Young (and to the companies in its network) are reported in detail in the notes to the annual and consolidated Financial Statements of Pirelli & C. as of December 31, 2012.

During 2011 the Committee and the Board of Statutory Auditors also defined a structured procedure for Pirelli to confer appointments (in particular, "non-audit" appointments) to member companies of the Ernst & Young network establishing the required prior and express authorisation by the Finance Director who, with the support of the Internal

<sup>63</sup> Refer to the Minutes of the Shareholders' Meeting held on April 29, 2008 available on the Company's Internet website.

Audit Director, is responsible for verifying that the appointment to be conferred is not included among the appointments which are prohibited by the Unified Statutory Audit Law and that, in any event, its characteristics do not influence the auditor's independence. The Board of Directors verified and approved the appointments report (in particular, the "non-audit" appointments) made during the financial year, subject to examination by the Committee for Internal Control, Risks and Corporate Governance.

Moreover, all the appointments which envisage a fee that exceeds 50 thousand euro, however, are required to be submitted to the prior examination by the Board of Statutory Auditors and the Committee for Internal Control, Risks and Corporate Governance, except in the case of motivated and specific reasons (for example: appointments not included in the auditing services, which the laws and regulations, also regulatory provisions, expressly establish are to be performed by the Auditor). The Internal Audit Director provides the Committee and the Board of Statutory Auditors with a list of non-audit services assigned to the auditor at least every quarter.

#### 14.6 OFFICER RESPONSIBLE FOR PREPARING THE COMPANY'S ACCOUNTING DOCUMENTS

The Company Bylaws<sup>64</sup> give the Board of Directors the authority to appoint the Responsible Officer, subject to the opinion expressed by the Board of Statutory Auditors, and establishing that the appointment expires together with the Board of Directors that appointed the Officer, unless revoked for just cause. The Responsible Officer must be an expert in administration and control and possess the integrity requirements es-

tablished for Directors.

In the meeting held on April 21, 2011 the Board of Directors confirmed Francesco Tanzi, Administration and Finance Director as the Responsible Officer with the approval of the Board of Statutory Auditors; the Responsible Officer is also in charge of the Group's Financial Statements and Taxes.

The Board of Directors confirmed the assignment of the following principal tasks to the Responsible Officer, pursuant to the laws and regulations currently applicable:

- to prepare adequate administrative and accounting procedures to draw up the annual and consolidated Financial Statements, as well as every other financial communication;
- to issue a written declaration attesting that the Company's documents and communications disclosed to the market and related to the accounting information, also the Company's interim communications and information correspond to the documentary evidence, books and accounting records;
- to attest the following details in a special report prepared in accordance with the model established in the Consob Regulations, annexed to the annual Financial Statements, to the abridged half-yearly Financial Statements and to the consolidated Financial Statements:
  - ■ the adequacy and the actual implementation of the procedures set out in sub-section a) above, during the period to which the documents refer; n
  - ■ that the documents are drawn up in compliance with the applicable International accounting standards recognised in the European Union, pursuant to (EC) regulation No. 1606/2002 of the European Parliament and Council dated July 19, 2002;
  - ■ that the documents correspond to the entries in the books and accounting records;
  - ■ that the documents are able to provide a true and fair representation of the equity, economic and cash flow position of the Company and of the set of businesses included in the consolidation;
  - ■ that the report on operations referred to the annual and consolidated Financial Statements, includes a reliable analysis of the trend and the operating results, as well as the situation relating to the Company and the set of businesses included in the consolidation, together with a description of

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<sup>64</sup> Article 11 of the Company Bylaws.

the principal risks and uncertainties to which they are exposed;

- ■ that the interim report on operations referred to the abridged half-yearly Financial Statements includes a reliable analysis of the information set out in Article 154-ter, paragraph 4 of the Unified Finance Law (TUF).

The Board of Directors has also conferred on the Responsible Officer all organisational and management powers required to exercise the tasks attributed by current laws and regulations, by the Company By-laws and by the Board of Directors. The Responsible Officer is granted full economic autonomy in order to exercise the powers conferred on him.

The Board of Directors supervises to ensure that the Responsible Officer has adequate means and powers to perform the duties assigned to him, as well as the actual compliance with the administrative and accounting procedures.

For this purpose the Responsible Officer reports directly to the Board of Directors, at least once a year, or through the Committee for Internal Control, Risks and Corporate Governance and to the Board of Statutory Auditors concerning the aspects within their area of jurisdiction.

The Responsible Officer reports promptly to the delegated administrative body, to the Board of Directors, also through the Committee for Internal Control, Risks and Corporate Governance concerning any aspects of significance which the Officer deems need to be declared in the certificate envisaged under Article 154-bis of the Unified Finance Law (TUF), if they are not corrected. The Responsible Officer is invited to attend the Board of Directors' meetings which include, on the Agenda, an examination of the economic and financial data and has direct access to all the information necessary to prepare the accounting data, with-

out requiring any authorisation; the Responsible Officer shares the internal flows for accounting purposes and approves all the company procedures which have an impact on the Company's economic, equity and cash flow position. The Responsible Officer attended all the Board of Directors' meetings of the Company for which the examination of the economic and financial data of the Company concerned was on the Agenda, and issued the attestations and declarations envisaged under Article 154-bis of the Unified Finance Law (TUF).

The Responsible Officer reported to the Committee for Internal Control, Risks and Corporate Governance and after approval of the so called "Interim Management Statements" and of the draft Financial Statements the Officer reported to Board of Directors concerning the adequacy and suitability of the powers and means conferred by the Company's Board of Directors, confirming that he had had direct access to all the information necessary to prepare the accounting data without needing any authorisation, had shared the internal flows for accounting purposes and had approved all the Company procedures which had an impact on the Company's economic, equity and cash flow position. During the financial year the Responsible Officer had issued the declarations and attestations envisaged under Article 154-bis of the Unified Finance Law (TUF).

## 15. DIRECTORS' INTERESTS AND TRANSACTIONS WITH RELATED PARTIES

The Company had established the principles of conduct, applicable since 2002, to execute transactions with related parties which were designed to assure a substantial and procedural correctness and transparency in the transactions executed by the Company, directly or through subsidiaries with the parties related to it.

The Company subsequently approved a specific and structured procedure for transactions with related parties (on November 3, 2010) following Consob's adoption of special regulations governing transactions with related parties in March 2010.

In particular, the Procedure adopted by the Company establishes procedural rules designed to enhance further the substantial and procedural transparency of the transactions executed by the Company with related parties.

The Board of Directors resolved to extend the application



of the Procedure and of the Consob Regulations to all the members of the Pirelli Shareholders' Agreement ("Sindacato di Blocco azioni Pirelli"), based on the proposal by the Committee for Internal Control, Risks and Corporate Governance (appointed in accordance with the Regulation concerned to express its opinion on the procedure), even if not eligible to be qualified as related parties by virtue of the provisions contained in the Regulations.

The procedural policies adopted by the Company are more rigorous compared to the requirements envisaged by the Regulations. For example: Pirelli adopted very restrictive low thresholds and established higher qualitative thresholds not prescribed by the Consob Regulations. In particular, Pirelli envisaged a very low threshold (150 thousand euro) (that has the consequence of exempting the transaction from the application of the procedure) compared to the thresholds normally adopted by other listed companies and a "qualitative" threshold that qualifies a transaction as being of "greater significance" (for which the prior approval by the Board of Directors is required, in addition to the approval of the Independent Directors), regardless of the corresponding value (and even if lower than the thresholds established by the Procedure) when the transaction concerned has a significant impact on Pirelli's business activities or may impact its managerial autonomy due to its nature, strategic importance, extent or commitments.

Furthermore, the Procedure has established that the opinion of the Committee for Transactions with Related Parties is also binding in the case of less significant transactions and has decided not to avail itself of the so-called whitewash mechanism in the event of an unfavourable opinion when concerning transactions with related parties of greater significance. In

addition, the Procedure is also applicable to transactions executed autonomously by the subsidiaries with parties related to the Company and not only the transactions executed "through" them, accordingly, the situation envisaged also in this case is significantly more rigorous compared to requirements set out in the Regulations.

The Company has envisaged that the Committee invited to express its opinion on the transactions with related parties is always to be composed exclusively of Independent Directors, thereby, confirming the importance acknowledged to the role of the Independent Directors (and not only in the case of transactions with related parties of greater significance, as envisaged by the Regulations). Therefore, the mandatory approval by the competent Committee is also envisaged in this case, by adopting a more rigorous approach for all transactions with related parties compared to the requirements established in the Consob Regulations, (therefore, also for the transactions of "lesser significance" and not only the transactions of "greater significance" as prescribed by Consob).

The Company has then envisaged the adoption of a remuneration policy to allocate the remunerations to Directors and Executives with strategic business responsibilities, including the policies relating to agreements for consensual termination of the employment relationship which make it possible to exempt these decisions from the ordinary procedure provided that (i) the definition of the remuneration policy involved a committee composed exclusively of non-executive Directors the majority of whom were Independent Directors (the reader is referred to the "Remuneration Committee" section; (ii) the policy was submitted to the advisory vote of the Shareholders' Meeting; (iii) the remuneration assigned is consistent with this policy (in this regard, the reader is referred to the Remuneration Policy section). Lastly, the Company adopted the Consob recommendation to envisage reviewing the Procedure at least every three years.

The Board has deemed that the advisory committees set up within the Board of Directors meet the characteristics and requirements envisaged by the Consob Regulations and those established by the Procedure submitted to the Board's examination, and accordingly, has conferred the powers of the Committee for Transactions with Related Parties envisaged, in accordance with the cited Procedure, to the Committee for Internal Control, Risks and Corporate Governance, with the sole exception of the responsibilities

concerning the remuneration of Directors and Executives with strategic business responsibilities, which are assigned to the Remuneration Committee.

The reader is referred to the Procedure published on the Pirelli Internet website for further information.

## 16. BOARD OF STATUTORY AUDITORS

The Board of Statutory Auditors is entrusted with monitoring the following aspects, in accordance with the law and the Company Bylaws:

- compliance with the law and the Company Bylaws;
- compliance with the principles of sound administration;
- the adequacy of the Company's organisational structure concerning the aspects within its area of jurisdiction, the internal control and the administrative and accounting system, as well as the dependability of the latter to represent correctly the operating results;
- the procedures to implement effectively the corporate governance rules envisaged by the codes of conduct prepared by the companies which manage the regulated markets or by the trade associations which the Company declares it abides by;
- the adequacy of the instructions issued by the Company to the subsidiaries in relation to the obligations to report price sensitive information<sup>65</sup>.

The Board of Statutory Auditors of listed companies monitors the following aspects, following the coming into force of Legislative Decree No. 39/2010:

- the financial reporting process;
- the efficiency of the internal control system, the internal audit, and risk management;
- the statutory audit of the annual ac-

counts and the consolidated accounts;

- the independence of the statutory auditor or the statutory auditing company, in particular, concerning services other than auditing services rendered to the company whose accounts are to be audited.

The Board of Statutory Auditors carries out its duties by exercising all the powers conferred on it by law and by being able to rely on a constant and detailed information flow from the Company, also outside the periodic meetings of the Board of Directors and the Committees.

When performing this functions, the Board of Statutory Auditors takes part in the work performed by the Remuneration Committee and the Committee for Internal Control, Risks and Corporate Governance, besides attending all the meetings of the Board of Directors and the Shareholders' Meetings and the Chairman of the Board of Statutory Auditors is invited to attend the meetings of the Appointments and Succession Committee and of the Strategies Committee. Moreover, statutory auditor Antonella Carù was invited to become a member of the Supervisory Body, in accordance with Legislative Decree No. 231/2001 (until 10 May 2012 departing statutory auditor Sfameni was a member of the Supervisory Body).

### 16.1 APPOINTMENT OF AUDITORS

The Company Bylaws envisage that the Board of Statutory Auditors is to be composed of three Statutory Auditors and two Alternate Auditors<sup>66</sup>. In order to permit the minority shareholders to elect one Statutory Auditor and one Alternate Auditor, the appointment is envisaged to be based on the so-called "voting list" system, according to which one Statutory Auditor and one Alternate Auditor are taken from the list that obtained the second highest number of votes (so-called minority list). The remaining members of the Board (namely, two Statutory Auditors and one Alternate Auditor) are taken instead from the list that obtained

<sup>65</sup> Now referred to as "privileged information" (Article 114 of the Unified Finance Law (TUF)).

<sup>66</sup> A proposal to amend Article 16, paragraph 1 was submitted to the Shareholders' Meeting convened to approve the 2012 financial statements to permit compliance with the applicable legislation regarding the balance between genders not only at the time the Auditors are appointed, but also in the case of their substitution during their term in office; the proposal entailed increasing the number of Alternate Auditors envisaged in the cited Article from two to three in order to introduce suitable succession mechanisms to ensure compliance with the balance between genders. The foregoing amendment is proposed to become effective from the first renewal of the control body after the coming into force of Law no. 120 dated July 12, 2011 (therefore, from the forthcoming renewal of the Board of Auditors). The Board of Auditors remains composed of three Statutory Auditors and two Alternate Auditors up to that date.

the highest number of votes (so-called majority list).

A proposal was submitted to the Shareholders' Meeting convened to approve the 2012 financial statements entailing a restructuring of the participation quotas required by the Bylaws to present the lists. In particular, the proposal entailed reducing the share capital quota (with voting rights in the ordinary shareholders' meeting) to 1% (compared to the current 1.5%) required to present the lists to appoint Board of Auditors, in any event, without prejudice to the lower quota required by the regulatory discipline issued by Consob<sup>67</sup>. In this regard, the reader is referred to the Directors' Report to the Shareholders' Meeting published on the Pirelli Internet Website.

The lists are to be registered at the Company's registered office at least 25 days prior to the date foreseen for the Shareholders' Meeting convened to resolve this point, unless extended, as envisaged by the applicable legislation. The Reader is referred to the current legislation, with regard to the latter point<sup>68</sup>, however, it is important to remember that if only one list is presented, or if multiple lists are presented by shareholders who are related, then the lists may be presented up to the fifth day after the deadline for the presentation of the lists (25 days prior to the Shareholders' Meeting), and the thresholds required for their presentation are reduced by half.

Each shareholder may present or participate in the presentation of only one list.

The following are to be provided together with the lists, also in accordance with the current legislation:

- information concerning the identity of the shareholders who presented the lists, with details of the percentage shareholding owned and a certificate that attests the ownership of the foregoing shareholding;

- a declaration by the shareholders other than the shareholders who hold a controlling, or relative majority shareholding, alone or jointly, to attest that they are unrelated;
- the description of the professional curriculum of the designated persons and the declarations in which the individual candidates accept the candidacy and attest under their own responsibility, that there are no grounds for their ineligibility or incompatibility and that they satisfy the requirements for the office, as prescribed by law or by the Company Bylaws.

Lists presented which fail to comply with the foregoing requirements are deemed not to have been presented.

Each candidate may appear on only one list, under penalty of ineligibility.

The lists are organised in two sections: one section for candidates to the position of Statutory Auditor and the other for candidates to the position of Alternate Auditor. The first candidate of the section must be identified from among the persons enrolled in the Register of Statutory Auditors who have worked as statutory auditors for a period of no less than three years.

Each person entitled to vote may vote for only one list.

The statutory member indicated as the first candidate on the minority list, if presented, shall be entitled to chair the Board of Statutory Auditors.

In the case of death, waiver or forfeiture of a Statutory Auditor, then the position shall be filled by the Alternate Auditor chosen from the same list as the former auditor no longer in office. If the Chairman of the Board of Statutory Auditors is to be substituted, then the chair shall be assigned to the other Statutory Auditor chosen from the same list as the former Chairman; if it is not possible to proceed with the substitutions in accordance with the above-mentioned criteria, a Shareholders' Meeting shall be convened to supplement the Board of Statutory Auditors and the Meeting shall resolve by relative majority vote.

When the Shareholders' Meeting is required to appoint the Statutory Auditors and/or Alternate Auditors necessary to supplement the Board of Statutory Auditors the Meeting shall proceed as follows: if auditors elected from the

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<sup>67</sup> With Resolution No. 18452 dated January 30, 2012 Consob established that the percentage shareholding required for shareholders to present the lists of candidates to be elected to the administrative and control bodies of Pirelli & C. shall correspond to 1 percent of the share capital with voting rights in the ordinary shareholders' meeting referred to the 2011 financial year.

<sup>68</sup> Issuers' Regulation: Article 144-quinquies and following articles. Moreover, CONSOB disseminated "Communication No. DEM/9017893 dated 26-2-2009" containing the recommendations regarding the "Appointment of members of administration and control bodies".

majority list are to be substituted, the appointment shall be made by relative majority, without list constraints; whereas, if auditors elected from the minority list are to be substituted, the Shareholders' Meeting shall substitute them by relative majority vote, selecting them, where possible, from among the candidates on the list that included the Auditor to be substituted. The principle of necessary representation of minorities, for which the Company Bylaws assure the right to participate in the appointment of the Board of Statutory Auditors shall be deemed to be complied with in the event of appointing Statutory Auditors who were candidates in the minority list, at the time, or on other lists differing from the list that had obtained the highest number of votes when the Board of Statutory Auditors was duly appointed. If only one list has been presented, the Shareholders' Meeting shall vote on that list; if the list obtains the relative majority then the candidates indicated in the respective section of the list shall be appointed as the Statutory Auditors and Alternate Auditors; the person indicated in first place in the cited list shall be appointed as the Chairman of the Board of Statutory Auditors.

The Shareholders' Meeting shall resolve with the majorities required by law when appointing the Auditors, who, for whatever reason, were not appointed in accordance with the procedure indicated herein.

Outgoing Auditors may be re-elected.

A proposal to amend Article 16, paragraph 1 was submitted to the Shareholders' Meeting convened to approve the 2012 financial statements to permit compliance with the applicable legislation regarding the balance between genders not only when appointing Auditors, but also in the case of their substitution during the term in office; the proposal entailed increasing the number of Alternate Auditors envisaged in the cited Article from two to three

in order to introduce suitable succession mechanisms to ensure compliance with the balance between genders. The foregoing amendment is proposed to become effective from the first renewal of the control body after the coming into force of Law no.120 dated July 12, 2011 (therefore, from the forthcoming renewal of the Board of Auditors). The Board of Auditors remains composed of three Statutory Auditors and two Alternate Auditors up to that date. Furthermore, it is proposed that the lists which present a number of candidates equal to or greater than three, considering both sections, shall include candidates of different gender in the section of the list referred to Statutory Auditors and in the section referred to Alternate Auditors. In order to foresee suitable supplementary criteria which permit compliance with the balance between genders on the Board of Auditors to be assured, a progressive automatic substitution mechanism is envisaged, if the application of the voting list mechanism does not assure the minimum requested number of Statutory Auditors or of Alternate Auditors of the gender less represented. It is proposed that the succession mechanism for the Alternate Auditor is to be supplemented with the provision whereby such succession must be arranged in accordance with the progressive order of presentation so as to ensure, however, compliance with the balance between genders. Similarly, it is proposed that the statutory provisions relating to the integration of the Board of Auditors by the Shareholders' Meeting, as well as other scenarios in which Auditors are appointed by the Shareholders' Meeting are to be supplemented with a specific provision according to which the formation of the Board of Auditors, in any event, must be determined in compliance with the balance between genders. In this regard, the reader is referred to the Directors' Report to the Shareholders' Meeting.

The meetings of the Board of Statutory Auditors may be attended – if the Chairman or whoever acts on his/her behalf establishes the need – by means of telecommunications media, which permit all the persons in attendance to participate in the discussion and obtain information on an equal basis.

## 16.2 AUDITORS

The Shareholders' Meeting held on May 10, 2012 appointed the Board of Statutory Auditors for the 2012 - 2014 financial years, by appointing Francesco Fallacara (appointed Chairman since drawn from the list presented by the minorities): Antonella Carù and Enrico Laghi as Statutory Auditors and by appointing Umile Sebastiano Iacovino and Andrea Lorenzatti (drawn from the minority list) as Alternate Auditors.

The appointment was based on the voting list system. The list presented by the members of the Pirelli & C. Shareholders' Agreement ("Sindacato di Blocco Azioni Pirelli & C.") obtained about 78% of the votes of the share capital with voting rights represented in the Shareholders' Meeting, while the minority list presented by a group of asset management companies and financial intermediaries<sup>69</sup> obtained approximately 22% of the votes of the share capital with voting rights represented in the Shareholders' Meeting.

The Shareholders' Meeting also established the annual gross fee to be paid to each Statutory Auditor at euro 50,000 and the annual gross fee to be paid to the Chairman of the Board of Statutory Auditors at euro 75,000.

Furthermore, the Statutory Auditor invited to take part in the Supervisory Body, pursuant to Legislative Decree No. 231/2001 (Antonella Carù) is to be paid an additional annual gross fee of euro 25,000.

Table No. 5 illustrates the composition of the Board of Statutory Auditors at the Date of the Report.

The list of positions held by Statutory Auditors in joint-stock companies, limited liability companies and companies with unlimited responsibility is published by Consob on its Internet website.

It is important to note that, at the Date of the Report, no Statutory Auditor in office

notified that he had exceeded the aggregate number of positions of administration and control envisaged under Article 144-terdecies of the Issuers' Regulations.

In line with the provisions contained in the Self-Regulatory Code<sup>70</sup> and as expressly ascertained by the Board of Statutory Auditors, based on the information provided by the Statutory Auditors and the information available to the Board of Statutory Auditors, all the Statutory Auditors can be qualified as independent on the basis of the criteria envisaged by the same Code referred to Directors, as well as in relation to Consob Communication No. 8067632 dated July 17, 2008<sup>71</sup>.

The Procedure for Transactions with Related Parties qualifies Statutory Auditors as parties related to the Company, in compliance with the regulatory provisions; accordingly, if the Statutory Auditor has an interest in a given Company transaction, the cited procedure shall apply, as described in greater detail in the preceding section "Directors' interests and transactions with related parties". It follows that the Board of Directors will receive adequate information concerning the nature of the relationship and how the transaction is to be executed, in line with the provisions set out in the Self-Regulatory Code<sup>72</sup>.

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<sup>69</sup> Anima SGR S.p.A., manager of the Prima Geo Italia and Anima Italia funds; APG Algemene Pensioen Groep N.V. manager of the Strichting Depository APG Developed Markets Equity Pool fund; Arca SGR S.p.A. manager of the Arca Azioni Italia and Arca BB funds; AZ Fund Management S.A. manager of the AZ Fund 1 Italian Trend fund; Credit Suisse Fund Management SA manager of the Credit Suisse Portfolio Fund (LUX) Reddito (Euro) and CS Equity Fund (LUX) Italy funds; Eurizon Capital SGR S.p.A. manager of the Eurizon Azioni Italia fund; Eurizon Capital SA manager of the following funds: Eurizon Stars Fund European Small Cap Equity, Eurizon Eurizon Stars Fund – Italian Equity, Eurizon Easy Fund Equity Consumer Discretionary LTE, Eurizon Easy Fund Equity Small Cap Europe; Fideuram Investimenti SGR S.p.A. Manager of the Fideuram Italia fund; Fideuram Gestioni SA manager of the following funds: Fonditalia Equity Italy, Fonditalia Euro Cyclical, Fideuram Fund Equity Italy, Fideuram Fund Equity Europe Growth and Fideuram Fund Equity Europe; Interfund Sicav manager of the Interfund Equity Italy funds; JP Morgan Asset Management (UK) Limited manager of the following funds: JPMorgan Funds, Commingled Pension Trust Fund (International Equity Index) of JPMorgan Chase Bank N.A., Commingled Pension Trust Fund (Intrepid International) of JP Morgan Chase Bank N.A., JP Morgan European Investment Trust Plc, JP Morgan Fund Icvc-JPM Europe Dynamic (formerly UK) Fund, JPM Fund Icvc – JPM Europe Fund, JP Morgan International Equity Index Fund, JP Morgan Intrepid European Fund and JP Morgan Intrepid International Fund; Mediolanum International Funds Limited – Challenge Funds; Mediolanum Gestione Fondi SGR S.p.A. manager of the Mediolanum Flessibile Italia fund; Pioneer Investment Management SGR S.p.A. manager of the Pioneer Italia Azionario Crescita fund and Pioneer Asset Management S.A.

<sup>70</sup> Self-Regulatory Code Application Criterion 10.C.2.

<sup>71</sup> CONSOB Communication No. DEM/DCL/DSG/8067632 dated 17-7-2008 concerning "Situations of incompatibility of the members of control bodies, pursuant to Article 148, paragraph 3, sub-section c) of the Unified Finance Law (TUF)".

<sup>72</sup> Self-Regulatory Code Application Criterion 8.C.4.

## ACTIVITIES OF THE BOARD OF STATUTORY AUDITORS

The Board of Statutory Auditors held 10 meetings during the financial year (6 meetings were held after the Board was renewed) and the percentage attendance of the Auditors was 95%, only one Auditor was recorded absent at one meeting. After its renewal all the members of the Board of Auditors participated in all of the Board's Meetings. The reader is referred to the table for a detailed representation of the attendance of the individual members of the Board of Statutory Auditors in the meetings held during the financial year.

Moreover, it is important to note that besides attending the Shareholders' Meetings and the meetings of the Board of Directors, the members of the Board of Statutory Auditors also attended the meetings held during the financial year by the Committee for Internal Control, Risks and Corporate Governance and the Remuneration Committee, a circumstance that characterises the rules of corporate governance adopted by the Company and offers the entire Board the possibility of overseeing directly the activities of the Committees and to perform the control functions assigned to it more effectively.

The Chairman of the Board of Statutory Auditors attended the meeting of the Appointments and Succession Committee and attended the meeting of the Strategies Committee.

During the financial year, the Board of Statutory Auditors monitored compliance with the law and the Company Bylaws, compliance with the principles of sound administration and the adequacy of the Company's organisational structure, the internal control system and the administrative and accounting system, as well as the dependability of the latter to represent correctly the operating events.

The Board also monitored the correct implementation of the corporate governance rules envisaged by the codes of conduct prepared by the companies that manage the regulated markets or by trade associations, which the company declares it abides by and the adequacy of the instructions the Company issues to the subsidiaries in relation to the obligations to disclose price sensitive information<sup>73</sup>.

The Board of Statutory Auditors reported on the activities performed to the Shareholders' Meeting held in April 2012 and expressed its opinion on the aspects within its area of jurisdiction concerning the Directors' proposal regarding the allocation of profits and the size of the dividend to be distributed.

The Board of Statutory Auditors monitored<sup>74</sup> the independence of the audit company checking compliance with the provisions applicable to this aspect and the nature and extent of the services other than auditing the accounts which are rendered to Pirelli & C. and to its subsidiaries by the same audit company and by other companies in the same network as the audit company.

Moreover, the Board of Statutory Auditors verified the correct application of the evaluation criteria and procedures adopted by the Board of Directors to assess the independence of its members.

The Board of Statutory Auditors<sup>75</sup> coordinated its activities with the Internal Audit Department and as has been stated, the respective members attended all the meetings of the Committee for Internal Control, Risks and Corporate Governance. The Board held periodic meetings with the representatives of the Audit Company, pursuant to Article 150, paragraph 3 of Legislative Decree No. 58/1998 which did not reveal significant data and information worthy of being reported.

Moreover, the Board of Statutory Auditors expressed opinions during the financial year, pursuant to Articles 2386 and 2389 of the Italian Civil Code.

With regard to the surveillance activity to monitor the effectiveness of the internal control systems, as already stated previously, the Board of Statutory Auditors has the tools required for the new tasks through its attendance in the meetings of the Committee for Internal Control, in particular, considering that the Board has received: (i) reports from the Internal Audit Management, at least every

<sup>73</sup> Now referred to as "privileged information" (Article 114 of the Unified Finance Law (TUF)).

<sup>74</sup> Also in line with the Self-Regulatory Code: Application Criterion 8.C.5

<sup>75</sup> Self-Regulatory Code: Application Criteria 8.C.6. and 8.C.7..

quarter; (ii) the audit plan once a year; (iii) the risk assessment and risk management plan once a year.

Lastly, the Board of Statutory Auditors examined in advance the results of the impairment test procedure which Pirelli decided to implement in compliance with the provisions of the international accounting standard IAS 36.

## 17. RELATIONS WITH SHAREHOLDERS

Pursuing its tradition of transparency, the Company manages with special attention the relations with Shareholders, with Investors (institutional and private investors), with financial analysts, with other market players and with the financial community, in general, in compliance with their reciprocal roles and by promoting periodic meetings in Italy and abroad. Moreover, the Investor Relations function was set up from March 1999 in order to favour an on-going dialogue with the financial market, and was entrusted to Ms. Valeria Leone from October 2008.

The Pirelli Internet website dedicates a section called Investors designed to establish an open, immediate and transparent dialogue with all parties requiring financial information concerning Pirelli; the Investors section includes the details required for an initial contact with Pirelli for evaluation purposes: the details provided include the characteristics which identify the Company, the economic and financial data, the drivers of the various businesses in which the Pirelli Group is involved, the opinions expressed by the financial analysts, all the documentation made available in the institutional meetings with the financial community, including the accounting and corporate documentation. Furthermore, Pirelli has prepared a section on the website dedicated to Retail in-

vestors in the case of individual investors: ([http://www.pirelli.com/corporate/en/investors/individual\\_investors/](http://www.pirelli.com/corporate/en/investors/individual_investors/)), this section focuses on the main events involving the Company, the performance of the Company's share, the implementation of strategies, business development, economic and financial results, Pirelli and PZero innovation/products. The services offered include the following: the weekly Stock Exchange report, the share performance calculation, the quarterly Newsletter IN, Blog (Investor Channel) and E-mail/SMS Alert. In addition, a section of the site is dedicated to the Common Representative for the savings shareholders and to information of interest for that category of shareholders.

The Investor Relations has an e-mail address ([ir@pirelli.com](mailto:ir@pirelli.com)) to facilitate the dialogue with the Company; answers are normally provided in 24 hours to the requests received via this e-mail address, while the Investors-Contacts section includes the contact information for the individual members of the IR team for specific requests from individual and institutional analysts and investors.

The Pirelli & C. Top management and the Investor Relations also use other typical financial communication tools in order to facilitate the knowledge of the Company's strategy, business development and the results achieved, for example: road shows, conference calls, one to one meetings and the participation in trade conferences for the businesses in which the Group is involved. Furthermore, the Company's culture includes combining profitability and sustainability in business and has received awards since it has been included in numerous world-wide assessment indexes relating to corporate social responsibility, an area in which the Company holds a recognised leadership position. The Company also intensified the dialogue with "Ethical investors" by participating in international conferences concerning governance and sustainability and by organising road shows dedicated to SRI funds in the principal financial centres.

## 18. SHAREHOLDERS' MEETINGS

The Shareholders' Meeting is convened as required by law and by the Company Bylaws by means of a Notice of Call published on the Pirelli Internet website. The Notice is generally published at least thirty days prior to the date fixed for the first call of the meeting, and if Shareholders' Meetings are convened to elect members of the administration and control bodies, the publication is made at least forty days prior to the date of the meeting.

The Notice of Call shall include the details of the date, time and place of the meeting and the list of topics to be discussed.

The Notice of Call shall contain, inter alia, a description of the procedures which the shareholders are required to comply with to attend the meetings and to exercise their voting rights in the meeting, as well as information concerning the following aspects (i) the right to ask questions prior to the meeting; (ii) the time limits and procedures to exercise the right to supplement the Agenda; (iii) the proxy voting procedure; (iv) the identity of the party (that the Company may have designated to confer proxy voting, as well as the procedures and time limits to confer the proxies).

The Shareholders' Meeting shall not resolve on matters which have not been included on the Agenda.

Shareholders who, alone or together, represent at least one fortieth of the share capital may request to supplement the list of topics to be discussed, or submit further proposals for discussion of matters already in the agenda, specifying the relative motives within five days from the date of publication of the Notice to convene the Shareholders' Meeting.

The Shareholders' Meeting is empowered to resolve, inter alia, on the following matters in ordinary or extraordinary sessions:

(i) the appointment and revocation of the members of the Board of Directors and the Board of Statutory Auditors and concerning their fees and responsibilities, (ii) approval of the Financial Statements and the allocation of profits, (iii) purchase and sale of treasury shares, (iv) amendments to the Company Bylaws, (v) the issuance of convertible bonds. The Shareholders' Meeting may be held in Italy, and also outside the Company's registered office, and the ordinary session shall be convened within 120 days from the end of the financial year, whereas, the Shareholders' Meeting convened to approve the Financial Statements may be convened within 180 days from the end of the financial year, pursuant to Article 2364 of the Italian Civil.

The Shareholders' Meeting is convened in single call and the majorities envisaged for the second call of the ordinary Shareholders' Meeting or for the third call of the extraordinary Shareholders' Meetings shall apply.

In this latter case, with the exception of specific matters for which the laws and regulations envisage a different majority, the Shareholders' Meeting in single call:

in the ordinary session:

- the Shareholders' Meeting convened shall be deemed validly constituted whatever portion of the share capital is represented by the shareholders in attendance and resolves with the absolute majority of the share capital represented;

in the extraordinary session:

- the Shareholders' Meeting convened shall be deemed validly constituted with the presence of shareholders representing at least one fifth of the share capital and resolves with the favourable vote of at least two thirds of the share capital represented.

Shareholders are entitled to view all the documents filed at the Company's registered office in the case of Shareholders' Meetings already called and to obtain a copy thereof at their own expense.

The proceedings of the Shareholders' Meetings are regulated by the law, by the Company Bylaws and by the Regulations for Shareholders' Meetings, duly approved by the Shareholders' Meeting held on May 11, 2004 and as subsequently amended by the Shareholders' Meeting held on April 23, 2007<sup>76</sup>.

The Shareholders' Meeting is chaired, in order of priority, by the Chairman of the Board of Directors, by a Deputy

<sup>76</sup> The Regulations for Shareholders' Meetings are detailed at the end of the Report and are available on the Internet website.



Chairman or by a Managing Director (the Meeting shall be chaired by the person most senior by age if there are two or more deputy Chairmen or Managing Directors). If the above-mentioned persons are absent, then the Meeting shall be chaired by another person duly appointed by the Meeting with the majority vote of the share capital represented in the Shareholders' Meeting.

The Chairman of the Shareholders' Meeting – *inter alia* – is required to verify that the Meeting has been duly constituted; ascertain the identity of the persons in attendance and their right to attend, also by proxy; ascertains the quorum required to resolve; manages the proceedings, also establishing a different order to discuss the topics indicated in the Notice of Call. In general, the Chairman adopts all appropriate measures for the purposes of ensuring the orderly progress of the debate and the voting, defining the procedures and ascertaining the results.

The resolutions passed by the Shareholders' Meeting are to be recorded in Minutes signed by the Chairman and by the Secretary or by the Notary Public. The Minutes of the extraordinary Shareholders' Meeting shall be drawn up by a Notary Public designated by the Chairman of the Shareholders' Meeting.

Following the changes introduced by Legislative Degree No. 27/2010 that introduced to Italian legislation the so-called record date mechanism the shareholders entitled to attend Shareholders' Meetings and entitled to cast their vote are those shareholders who, based on a communication from the intermediary to the Company, are entitled to attend the meeting and cast their vote at the close of the accounting day on the seventh trading day prior to the date set for the meeting in first call or only call. The credit and debit records performed on accounts after this deadline will not influ-

ence the entitlement to vote at the Shareholders' Meeting. Shareholders with voting rights may be represented by means of a proxy issued in accordance with the procedures envisaged by the applicable law and regulations. The Company shall designate for each Shareholders' Meeting one or more parties that Shareholders entitled to cast their vote in the Meeting may appoint as a proxy with instructions for voting on all or some of the items on the Agenda. The proxy shall not apply with regard to proposals for which no voting instructions have been given. The designated parties, the procedures and the time limits to confer proxies are detailed in the Notice of Call of the Shareholders' Meeting. The proxy may also be notified to the Company in an electronic form by using one of the following alternative methods:

- use of the relevant section on Pirelli's Internet website, indicated by the Company in the Notice of Call;
- sending a message to the certified e-mail address indicated by the Company in the Notice of Call.

The Notice of Call may also identify one of the foregoing methods as the preferred method to be used on the date of the single Shareholders' Meeting to which the Notice refers. With reference to the right of each person attending the Meeting to take the floor to speak on the topics under discussion, it is important to note that the Regulations for Shareholders' Meetings envisage that the Chairman may, at the beginning of the Meeting, and taking into account the importance of the individual items on the Agenda, determine the amount of time available to each speaker to express his/her view, where such time that must not be less than 15 minutes. Those wishing to take the floor shall request the Chairman or the Secretary to give them the floor, and shall identify the topic to which their intervention refers. The request may be submitted until the Chairman has declared closed the discussion of the item to which the request for the floor refers. The persons in attendance may ask for the floor a second time during the course of the same discussion, for a time of no more than 5 minutes, solely for the purpose of replying or to express voting declarations.

The Regulations empower the Chairman of the meeting to grant the shareholders that made such a request, pursuant to law and the Company Bylaws, to add no more than 15 minutes of discussion time on the topics on the Agenda to illustrate the corresponding resolution proposals and to explain the respective reasons.

Following the changes introduced by Legislative Decree No. 27/2010, shareholders may ask questions on the topics on the Agenda, even prior to the meeting, in accordance with the procedures indicated in the Notice of Call. The questions received prior to the meeting shall be answered no later than during the meeting concerned, also by means of a single answer that refers to other similar questions. No answer is required if the information requested is already available in a “questions and answers” format on Pirelli’s Internet website.

## 2012 SHAREHOLDERS’ MEETINGS

One Shareholders’ Meeting was held during the 2012 financial year, on May 10, 2012, in single call with the participation of about 67.97% of the ordinary share capital to discuss (i) approval of the Financial Statements as of 31 December 2011 (approved by the favourable votes of 99.854% of the share capital represented at the meeting); (ii) the appointment of two members of the Board of Directors (approved by the favourable votes of approximately 98% of the share capital represented at the meeting); (iii) the appointment of the Board of Auditors (in this regard, the reader is referred to section 4 “Board of Auditors”); (iv) a Consultation on the Group’s General Remuneration Policy (approved by the favourable votes of 83.118% of the share capital represented at the meeting); (v) the three-year monetary incentive plan for the Group’s management (approved by 98.47% of the capital represented in the meeting).

The following documents, inter alia, are available on the Company’s Internet website for each shareholders’ meeting: (i) Notice of Call; (ii) a copy of the Minutes of the Shareholders’ Meeting; (iii) a summary report on the votes cast; (iv) documents, reports and resolution proposals examined by the Shareholders’ Meeting (v) the press

release distributed by the Company outlining the proceedings of the Shareholders’ Meeting.

## SHAREHOLDERS’ MEETING OF SAVINGS SHAREHOLDERS

As far as the Shareholders’ Meeting of the savings shareholders is concerned this Meeting is convened by the Common Representative of the Company’s savings shareholders, or by the Company’s Board of Directors, whenever they deem it appropriate or when the Meeting is to be convened, as provided for by law.

The special Shareholders’ Meeting of the savings shareholders is chaired by the Common Representative of the Company’s savings shareholders or, in his absence, by the person elected with the favourable vote of the majority of the share capital represented at the Shareholders’ Meeting. Pursuant to the Company Bylaws<sup>77</sup> the expenses relating to the organisation of the special category Shareholders’ Meeting and the remuneration of the Common Representative are to be borne by the Company.

The Shareholders’ Meeting of the savings shareholders held in third call on January 31, 2012 appointed prof. Giuseppe Niccolini (in replacement of Giovanni Pecorella, lawyer) as the Common Representative for the savings shareholders for the 2012-2014 financial years (with the favourable vote of 99.941% of the category share capital in attendance at the Shareholders’ Meeting) the Meeting also established the respective fee of 15 thousand euro (with the favourable vote of 99.941% of the category share capital in attendance at the Shareholders’ Meeting) and unanimously approved to establish the fund for the expenses necessary to protect the common interests of the category. At the time the Common Representative was reappointed, the savings Shareholders expressed their views with separate voting concerning the appointment of the Common Representative and the definition of the fee and the common fund.

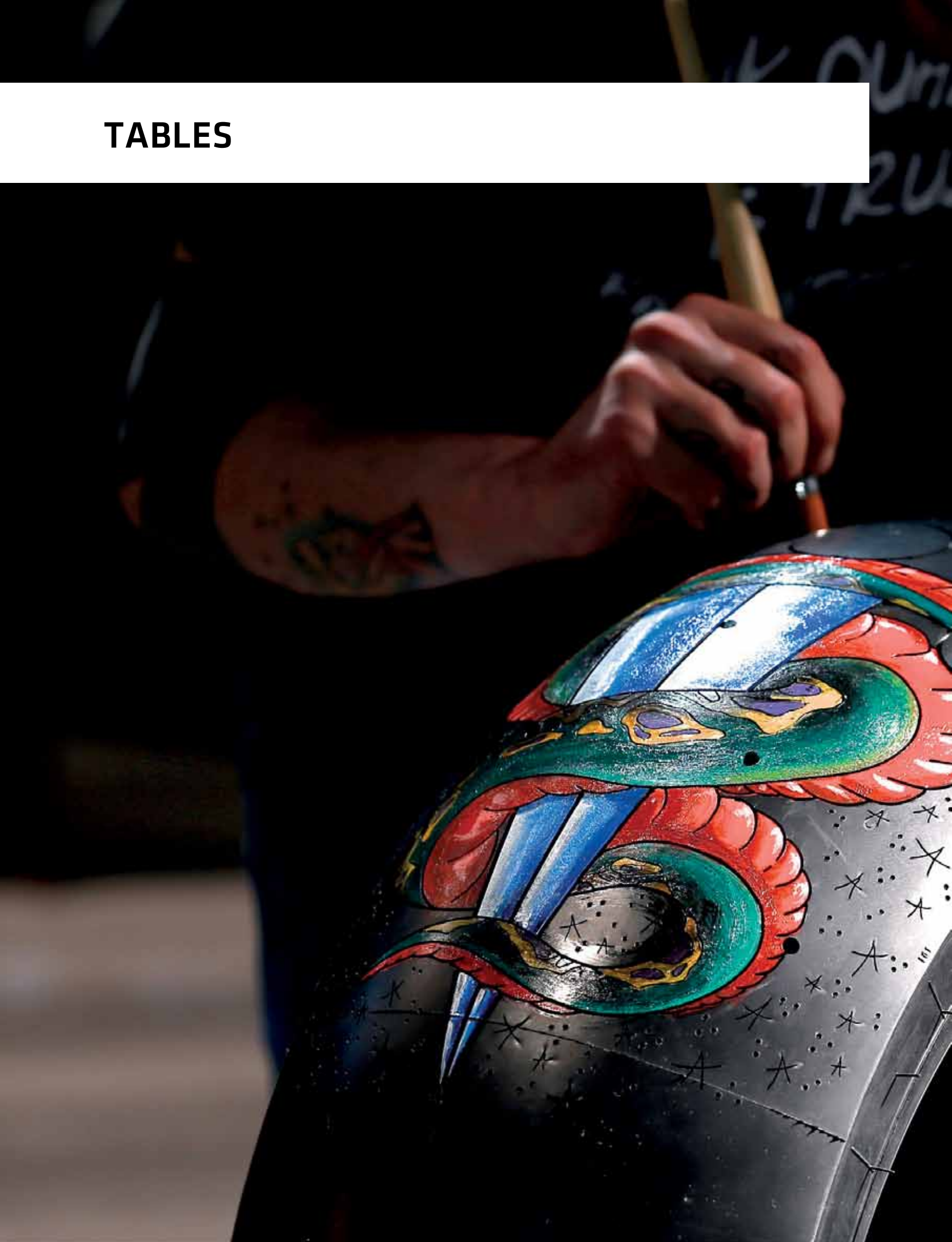
## 19. CHANGES OCCURRING AFTER YEAR-END

The Report takes into account the changes which occurred from year-end up to the Date of the Report.

<sup>77</sup> Article 6 of the Company Bylaws.



# TABLES





# TABLES

Table 1

## SHARE CAPITAL STRUCTURE

The exact composition of the share capital is shown below.

	No. shares	% of share capital	Listing
Ordinary shares*	475,740,182	97.49%	Listed on the Italian Stock Exchange MTA – Blue Chip Segment
Savings shares**	12,251,311	2.51%	Listed on the Italian Stock Exchange MTA – Blue Chip Segment

\*Ref ISIN IT0000072725

\*\* Ref ISIN IT0000072733

Table 2

## MAIN SHAREHOLDINGS

Listed below are the entities which, according to the Consob website at the date of publication of this report, hold voting shares at the ordinary shareholders' meeting amounting to more than 2% of the ordinary capital.

Registered owner or entity at the top of the shareholder chain	Direct Shareholder		% of Voting Capital				% of Ordinary Capital			
	Name	Title of Ownership	%	of which Without Voting Rights			%	of which Without Voting Rights		
				%	Voting Rights to			Quota %	Voting Rights to	
					Entity	%			Entity	%
<b>MARCO TRONCHETTI PROVERA</b>	CAM 2012 SPA	Owner	5.850	0.000			5.850	0.000		
		Total	5.850	0.000			5.850	0.000		
	CAM PARTECIPAZIONI SPA	Owner	0.023	0.000			0.023	0.000		
		Total	0.023	0.000			0.023	0.000		
	CAMFIN SPA	Owner	20.320	0.000			20.320	0.000		
		Total	20.320	0.000			20.320	0.000		
<b>Total</b>		<b>26.193</b>	<b>0.000</b>			<b>26.193</b>	<b>0.000</b>			
<b>FINSOE SPA</b>	POPOLARE VITA SPA	Owner	0.003	0.000			0.003	0.000		
		Total	0.003	0.000			0.003	0.000		
	MILANO ASSICURAZIONI SPA	Owner	0.025	0.000			0.025	0.000		
		Total	0.025	0.000			0.025	0.000		
	FONDIARIA - SAI SPA	Owner	4.454	0.000			4.454	0.000		
		Total	4.454	0.000			4.454	0.000		
<b>Total</b>		<b>4.482</b>	<b>0.000</b>			<b>4.482</b>	<b>0.000</b>			
<b>RUANE CUNNIF &amp; GOLDFARB INC.</b>	RUANE CUNNIF & GOLDFARB INC.	Discretionary portfolio management	2.356	0.000			2.356	0.000		
		Total	2.356	0.000			2.356	0.000		
	<b>Total</b>		<b>2.356</b>	<b>0.000</b>			<b>2.356</b>	<b>0.000</b>		
<b>ASSICURAZIONI GENERALI SPA</b>	ALLEANZA TORO SPA	Owner	0.126	0.000			0.126	0.000		
		Total	0.126	0.000			0.126	0.000		
	GENERALI VIE SA	Owner	1.097	0.000			1.097	0.000		
		Total	1.097	0.000			1.097	0.000		
	INA ASSITALIA SPA	Owner	2.005	0.000			2.005	0.000		
		Total	2.005	0.000			2.005	0.000		
	ASSICURAZIONI GENERALI SPA	Owner	1.731	0.000			1.731	0.000		
		Total	1.731	0.000			1.731	0.000		
<b>Total</b>		<b>4.959</b>	<b>0.000</b>			<b>4.959</b>	<b>0.000</b>			
<b>EDIZIONE SRL</b>	EDIZIONE SRL	Owner	4.773	0.000			4.773	0.000		
		Total	4.773	0.000			4.773	0.000		
	<b>Total</b>		<b>4.733</b>	<b>0.000</b>			<b>4.773</b>	<b>0.000</b>		
<b>ALLIANZ SE</b>	ANTONIANA VENETA POPOLARE VITA SPA	Owner	0.001	0.000			0.001	0.000		
		Total	0.001	0.000			0.001	0.000		
	CREDITRAS VITA SPA	Owner	0.001	0.000			0.001	0.000		
		Total	0.001	0.000			0.001	0.000		
	ALLIANZ SPA	Owner	4.518	0.000			4.518	0.000		
		Total	4.518	0.000			4.518	0.000		
<b>Total</b>		<b>4.520</b>	<b>0.000</b>			<b>4.520</b>	<b>0.000</b>			
<b>MEDIOBANCA SPA</b>	MEDIOBANCA SPA	Owner	4.608	0.000			4.608	0.000		
		Total	4.608	0.000			4.608	0.000		
	<b>Total</b>		<b>4.608</b>	<b>0.000</b>			<b>4.608</b>	<b>0.000</b>		

Note:

Information on shareholders who, directly or indirectly, own ordinary shares with more than 2% of the voting capital in the ordinary shareholders' meetings of the company is taken from the Consob website. Note that the information published by Consob on its website is based on disclosures by the entities as required by Article 120 TUF and the Issuer Regulations. These figures may differ significantly from the actual situation, in that the obligation to disclose changes to ownership quotas is not triggered by any change in the quotas as such, but only when "exceeding" or "falling below" predetermined thresholds (2%, 5%, and successive multiples of 5% up to the threshold of 30% and, above this threshold, 50, 66.6%, 90% and 95%). It follows that, for example, a shareholder (i.e. registered owner) who claims to possess 2.6% of the voting capital may increase their stake up to 4.9% without being obliged to report any change to Consob under Article 120 TUF.

Table 3

## COMPOSITION OF THE BOARD OF DIRECTORS

The Composition of the Board of Directors at the report date is shown below.

Name	Position	In office since	List	Exec	Non exec	Indep	Indep TUF	% Board	First appointment in Pirelli & C. S.p.A.
Marco Tronchetti Provera	Chairman	21/04/2011	Maj.	X				100%	07/05/2003
Vittorio Malacalza	Vice Chairman	21/04/2011	Maj.		X			80%	29/07/2010
Alberto Pirelli	Vice Chairman	21/04/2011	Maj.	X				100%	07/05/2003
Carlo Acutis	Director	21/04/2011	Maj.		X	X	X	80%	07/05/2003
Anna Maria Artoni	Director	21/04/2011	Maj.		X	X	X	100%	21/04/2011
Gilberto Benetton	Director	21/04/2011	Maj.		X			80%	07/05/2003
Alberto Bombassei	Director	21/04/2011	Maj.		X	X	X	80%	12/09/2006
Franco Bruni	Director	21/04/2011	Min.		X	X	X	100%	28/04/2005
Luigi Campiglio	Director	21/04/2011	Maj.		X	X	X	100%	29/04/2008
Pietro Guindani	Director	21/04/2011	Min.		X	X	X	100%	21/04/2011
Giulia Maria Ligresti	Director	21/04/2011	Maj.		X			80%	07/05/2003
Elisabetta Magistretti	Director	21/04/2011	Min.		X	X	X	100%	21/04/2011
Massimo Moratti	Director	21/04/2011	Maj.		X			40%	07/05/2003
Renato Pagliaro	Director	21/04/2011	Maj.		X			100%	29/04/2008
Luigi Roth	Director	26/07/2012	Maj.		X	X	X	100%	23/04/2007
Carlo Salvatori*	Director	21/04/2011	-		X			100%	26/07/2012
Carlo Secchi	Director - LID	01/03/2012	Maj.		X	X	X	100%	19/02/2004
Manuela Soffientini**	Director		-		X	X	X	100%	01/03/2012

Number of Board of Directors' meetings in FY 2012: 5.

### Key

List: Maj./Min. depending on whether the director was elected from a list voted by the majority or by the minority.

Exec.: X indicates an executive director.

Non exec.: X indicates a non-executive director.

Indep.: X indicates an independent director under the criteria of the Corporate Governance Code.

Indep. TUF: X indicates a director who meets the criteria of independence under Article 148, para 3, of TUF.

% Board: indicates the director's presence in percentage terms at Board meetings. (The percentage is calculated from the number of meetings attended out of the number of meetings held during the director's effective period in office).

\* Appointed Company Director on 26/07/2012 under Article 2386 of the Italian Civil Code, with a mandate that expires with the Shareholders' Meeting to approve the 2012 Annual Financial Report.

\*\* Appointed Company Director on 1 March 2012 under Article 2386 of the Italian Civil Code, and subsequently confirmed by the Shareholders' Meeting of 10 May 2012.



Directors who ceased to hold office during the financial year:

Name	Position	In office from/to	List	Exec	Non exec	Indep	Indep TUF	% Board
Paolo Ferro-Luzzi	Director	from 21/04/2011 to 11/11/2012	Maj.		X	X	X	100%
Mario Greco*	Director	from 12/11/2012 to 04/03/2013	-		X			-
Giovanni Perissinotto	Director	from 21/04/2011 to 23/07/2012	Maj.		X			100%
Giuseppe Vita**	Director	from 01/03/2012 to 25/05/2012	-		X			100%

**Key**

See key to the two previous tables.

\* Appointed Company Director under Article 2386 of the Italian Civil Code on 12/11/2012 and resigned on 04/03/2013. In FY 2012 no Board meetings were held subsequent to the appointment of Greco as Director.

\*\* Co-opted Company Director on 1 March 2012 and subsequently confirmed by the Shareholders' Meeting of 10 May 2012.

Table 4

## COMPOSITION OF THE BOARD OF DIRECTORS' COMMITTEES

The composition of the Committees formed within the Board of Directors at the report date is shown below:

### INTERNAL CONTROL, RISKS AND CORPORATE GOVERNANCE COMMITTEE

Name	Position	Committee member since	List	Exec	Non exec	Indep	% Committee
Carlo Secchi	Chairman	21/04/2011	Maj.		X	X	100%
Franco Bruni	Member	21/04/2011	Min.		X	X	100%
Elisabetta Magistretti	Member	21/04/2011	Min.		X	X	92%
Luigi Roth	Member	21/04/2011	Maj.		X	X	83%

Number of Committee meetings in FY 2012: 12.

### REMUNERATION COMMITTEE

Name	Position	Committee member since	List	Exec	Non exec	Indep	% Committee
Carlo Acutis	Chairman	21/04/2011	Maj.		X	X	100%
Anna Maria Artoni	Member	21/04/2011	Maj.		X	X	100%
Pietro Guindani	Member	21/04/2011	Min.		X	X	100%
Luigi Roth	Member	21/04/2011	Maj.		X	X	100%

Number of Committee meetings in FY 2012: 3.

## STRATEGIES COMMITTEE

Name	Position	Committee member since	List	Exec	Non exec	Indep	% Committee
Marco Tronchetti Provera	Chairman	21/04/2011	Maj.	X			100%
Vittorio Malacalza	Member	21/04/2011	Maj.		X		100%
Alberto Bombassei*	Member	26/07/2012	Maj.		X	X	-
Franco Bruni	Member	21/04/2011	Min.		X	X	100%
Renato Pagliaro	Member	21/04/2011	Maj.		X		100%
Carlo Secchi	Member	21/04/2011	Maj.		X	X	50%
Manuela Soffientini*	Member	26/07/2012	-		X	X	-
Francesco Chiappetta	Member	21/04/2011	Pirelli Executive				100%

Number of Committee meetings in FY 2012: 2.

## NOMINATIONS AND SUCCESSION COMMITTEE

Name	Position	Committee member since	List	Exec	Non exec	Indep	% Committee
Marco Tronchetti Provera	Chairman	21/04/2011	Maj.	X			100%
Vittorio Malacalza	Member	21/04/2011	Maj.		X		100%
Luigi Campiglio	Member	21/04/2011	Maj.		X	X	100%
Luigi Roth	Member	21/04/2011	Maj.		X	X	100%

Number of Committee meetings in FY 2012: 1

## Key

\*: In FY 2012, subsequent to the appointment of Directors Bombassei and Soffientini as members of the Strategies Committee no meetings were held.  
List: Maj./Min. depending on whether the member was elected from a list voted by the majority or by the minority (article 144-decies, of the Issuer Regulations).

Exec.: X indicates an executive director.

Non exec.: X indicates a non-executive director.

Indep.: X indicates an independent director under the criteria of the Corporate Governance Code, specifying in attachment to the table whether the criteria were integrated or modified.

% Committee: indicates the director's presence in percentage terms at committee meetings. (The percentage is calculated from the number of meetings attended out of the number of meetings held during the director's effective period in office).

## COMMITTEE MEMBERS WHO CEASED TO HOLD OFFICE DURING THE FINANCIAL YEAR:

Name	Position	In office from/to	R.C.	ICRCGC	Str. C.	Nom. and Succ. C.	% Committee
Paolo Ferro-Luzzi	Member	from 21/04/2011 to 11/11/2012		X			56%
Francesco Gori	Pirelli Executive	from 21/04/2011 to 10/05/2012			X		50%

## Key

See key to the two previous tables.

Table 5

## COMPOSITION OF THE BOARD OF STATUTORY AUDITORS

Name	Position	In office since	List	Indep Corp. Gov. Code	% Board	% S.C.	% ICRCGC	% R.C.	% Nom.
Francesco Fallacara	Chairman	10/05/2012	Min.	X	100%	100%	100%	-	-
Enrico Laghi*	Effective Auditor	10/05/2012	Maj.	X	80%	100%	92%	100%	100%
Antonella Carù	Effective Auditor	10/05/2012	Maj.	X	100%	100%	100%	-	-
Umile Sebastiano Iacovino	Alternate auditor	10/05/2012	Maj.	-	-	-	-	-	-
Andrea Lorenzatti	Alternate auditor	10/05/2012	Min.	-	-	-	-	-	-

\* Auditor Enrico Laghi was Chairman of the Statutory Board of Auditors from 21/04/2009 to 10/05/2012.

### Key

Position: Chairman, Effective Auditor or Alternate auditor.

List: Maj./Min. depending on whether the auditor was elected from a list voted by the majority or by the minority (article 144-decies, of the Issuer Regulations).

Indep.: X indicates an auditor under the criteria of the Corporate Governance Code, specifying in attachment to the table whether the criteria were integrated or modified.

The percentages below are calculated from the number of meetings attended out of the number of meetings held during the auditor's effective period in office:

% S.C.: indicates presence in percentage terms at Board of Statutory Auditors meetings.

% BoD: indicates presence in percentage terms at Board meetings.

% ICRCGC: indicates presence, in percentage terms, at the meetings of the Internal Control, Risks and Corporate Governance Committee.

% Nom. C.: indicates presence, in percentage terms, at the meetings of the Nominations and Succession Committee.

% R.C.: indicates presence in percentage terms at Remuneration Committee meetings.

You are reminded that the Chairman of the Board of Statutory Auditors is invited to take part in the Nominations and Succession Committee and may also be invited to take part in the Strategies Committee. On this point, we observe that the Chairman of the Board of Statutory Auditors also attended all meetings of the Strategies Committee to which he was invited.

Members of the Board of Statutory Auditors who ceased to hold office during the financial year:

Name	Position	In office since	List	Indep Corp. Gov. Code	% Board	% S.C.	% ICRCGC	% R.C.	% Nom.
Paolo Gualtieri	Effective Auditor	From 21/04/2009 to 10/05/2012	Maj.	X	67%	75%	100%	33%	-
Paolo Domenico Sfameni	Effective Auditor	From 21/04/2009 to 10/05/2012	Maj.	X	100%	100%	100%	33%	-
Luigi Guerra	Alternate auditor	From 21/04/2009 to 10/05/2012	Maj.	-	-	-	-	-	-
Franco Ghiringhelli	Alternate auditor	From 21/04/2009 to 10/05/2012	Maj.	-	-	-	-	-	-

### Key

See key to the two previous tables.

\* The percentage is calculated from the number of meetings attended out of the number of meetings held during the individual's effective period in office.

## LIST OF THE MAIN OFFICES HELD BY THE DIRECTORS IN OTHER COMPANIES NOT BELONGING TO PIRELLI GROUP

<b>Marco Tronchetti Provera</b>	Marco Tronchetti Provera & C. S.p.A.	Chairman
	Camfin S.p.A.	Chairman
	Gruppo Partecipazioni industriali S.p.A.	Chairman
	Prelios S.p.A.	Chairman
	Mediobanca S.p.A.	Vice Chairman
	F.C. Internazionale Milano S.p.A.	Director
<b>Vittorio Malacalza</b>	HOFIMA S.p.A	Chairman
	Malacalza Investimenti S.r.l.	Chairman
	Camfin S.p.A.	Director
	ASG Supercondutores S.p.A.	Director
	Sima & Tectubi S.p.A.	Director
	Beta Zero S.r.l.	Chairman
	Columbus Superconductors S.p.A.	Chairman
	Egida S.r.l.	Chairman
Stuarta Immobiliare S.p.A.	Sole Director	
<b>Alberto Pirelli</b>	Camfin S.p.A.	Director
	KME S.p.A.	Director
<b>Carlo Acutis</b>	Vittoria Assicurazioni S.p.A.	Vice Chairman
	Banca Passadore S.p.A.	Vice Chairman
	Yafa S.p.A.	Director
	YAM INVEST N. V.	Vigilance Director
<b>Anna Maria Artoni</b>	Artoni Group S.p.A.	Sole Director
	Artoni Trasporti S.p.A.	Vice Chairman and CEO
	Artoni Logistica S.r.l.	Director
	Artoni&Samer S.r.l.	Chairman
	Fondazione Ente Cassa di Risparmio di Pistoia e Pescia	Director
	Linkiesta.it	Director
<b>Gilberto Benetton</b>	Edizione S.r.l.	Chairman
	Atlantia S.p.A.	Director
	Autogrill S.p.A.	Chairman
	Benetton Group S.p.A.	Director
	Mediobanca S.p.A.	Director
	Sintonia S.A.	Director
<b>Alberto Bombassei</b>	Brembo S.p.A.	Chairman
	Italcementi S.p.A.	Director
	Atlantia S.p.A.	Director
	Fiat Industrial S.p.A.	Director
	Nuovo Trasporto Viaggiatori S.p.A.	Director

Franco Bruni	Unicredit Audit S.p.A.	Director
	Pioneer Investment Management sa	Director
Luigi Campiglio	Allianz Bank Financial Advisor	Director
Pietro Guindani	Vodafone Omnitel N.V.	Chairman
	Impregilo S.p.A.	Director
	Assonime	Director
Giulia Maria Ligresti	Fondazione Fondiaria-SAI	Chairman
Elisabetta Magistretti	Mediobanca S.p.A.	Director
	Luxottica Group S.p.A.	Director
Massimo Moratti	F.C. Internazionale Milano S.p.A.	Chairman
	SARINT S.A	Chairman
	SARAS S.p.A. Raffinerie Sarde	CEO
	GUT Edizioni S.p.A.	Director
	Angelo Moratti di Gian Marco Moratti e Massimo Moratti & C. S.p.A.	Chairman
Renato Pagliaro	Mediobanca S.p.A.	Chairman
	Telecom Italia S.p.A.	Director
	Istituto Europeo di Oncologia s.r.l.	Effective Auditor
Luigi Roth	Terna - Rete Elettrica Nazionale S.p.A.	Chairman
	Terna Rete Italia S.r.l.	Chairman
	Melior Valorizzazioni Immobili S.r.l.	Chairman
	Alba Leasing S.p.A.	Chairman
	Autostrada Torino - Milano S.p.A.	Director
Carlo Salvatori	Allianz S.p.A.	Chairman
	Lazard S.r.l.	Chairman
	Chiesi Farmaceutici S.p.A.	Director
	API - Anonima Petroli Italiana S.p.A.	Director
	Riso Gallo S.p.A.	Director
Carlo Secchi	Mediolanum S.p.A.	Chairman
	Italcementi S.p.A.	Director
	Mediaset S.p.A.	Director
Manuela Soffientini	Electrolux Appliances S.p.A.	Chairman and CEO

## ATTACHMENT B

## ABRIDGED FORM OF PIRELLI & C. SOCIETÀ PER AZIONI SHAREHOLDERS AGREEMENT

### 1. TYPE AND OBJECTIVE OF THE AGREEMENT

The purpose of the Pirelli & C. shareholders agreement is to ensure a stable shareholder base and uniform strategy in the management of the company.

### 2. PARTIES TO THE SHAREHOLDERS AGREEMENT AND PIRELLI & C. SHARES TRANSFERRED TO THE AGREEMENT:

Participant	Number of ordinary Shares granted	% of all shares granted	% of the total n. of ordinary shares issued
CAMFIN S.p.A.	96,669,168	44.64	20.32
MEDIOBANCA S.p.A.	21,922,205	10.12	4.61
EDIZIONE S.r.l.	21,921,364	10.12	4.61
FONDIARIA - SAI S.p.A.	21,032,307	9.71	4.42
ALLIANZ S.p.A.	20,977,270	9.69	4.41
ASSICURAZIONI GENERALI S.p.A. (*)	20,977,269	9.69	4.41
INTESA SANPAOLO S.p.A.	7,683,568	3.55	1.62
SINPAR S.p.A.	3,015,320	1.39	0.63
Massimo MORATTI (**)	2,343,392	1.08	0.49
Total	216,541,863	100	45.52

(\*) Including n. 5,218,181 shares through Generali Vie S.A. and n. 7,525,388 shares through Ina Assitalia S.p.A..

(\*\*) through CMC S.p.A. (including 1,838,459 shares fiduciary owned by Cordusio Società fiduciaria per azioni).

### 3. THE PARTY, IF ANY, WHICH, THROUGH THE AGREEMENT, CAN EXERCISE CONTROL OVER THE COMPANY

There is no party which, through the agreement, can exercise control over Pirelli & C..

### 4. RESTRICTIONS ON THE SALE OF THE SHARES TRANSFERRED AND ON THE SUBSCRIPTION AND THE PURCHASE OF NEW SHARES

The sale of the shares to third parties (and option rights in the event of a capital increase) is prohibited. Shares can be sold freely and pre-emptively to subsidiaries, according to article 2359, paragraph 1, point 1 of the Italian Civil Code, and to the parent companies as well as other participants to the shareholders agreement. Each participant may buy or sell additional shares for an amount not in excess of the higher of 20% of the shares already transferred by the participant itself and 2% of the ordinary share capital issued; purchases of greater amounts are permitted only with the intent of reaching a holding equal to 5% of the ordinary share capital issued, on condition that the amount in excess of the above limits came under the shareholders agreement.

CAMFIN S.p.A. is authorized to freely purchase additional Pirelli & C. shares; it can transfer shares to the shareholders agreement, but to the extent that, at any one time, the shares do not exceed 49.99% of total shares transferred by all the participants in the shareholders agreement. This has been decided so that a stable predominate position is not assumed in the shareholders agreement or a stable veto power is not exercised over common decisions.

Except where the Pirelli & C. ordinary shares in the shareholders agreement correspond to the majority of the voting rights in the ordinary shareholders' meetings, each participant (also through parent companies and/or subsidiaries) intending to purchase shares of that category shall inform the President in writing beforehand and the President shall inform the participant if, taking into account the laws in force concerning tender offers, the participant can proceed, in whole or in part, with the proposed purchase.

## **5. AVAILABILITY OF THE SHARES**

The shares transferred shall remain at disposal of the participants in the shareholders agreement.

## **6. BODIES GOVERNING THE AGREEMENT, COMPOSITION, MEETINGS AND POWERS**

The Body governing the agreement is the Shareholders Agreement Executive Committee.

The Shareholders Agreement Executive Committee shall consist of a president and vice-president, in the form of the president and the longest serving vice-president of Pirelli & C., and by a member representing each participant unless a participant has deposited more than 10% of ordinary share capital, in which case another member may be designated: for this purpose, in the event the shareholders agreement is composed of several companies related by a controlling relationship or belonging to the same parent company, their aggregate shall be considered for this purpose as one sole participant in the shareholders agreement.

The Shareholders Agreement Executive Committee shall be convened to evaluate the proposals to be submitted to the shareholders' meetings, for the possible earlier termination of the agreement and for the admission of new participants. The Shareholders Agreement Executive Committee shall also meet at least twice a year to examine the semiannual performance, the annual results, the general guidelines for the company's development, the investment policy and proposed significant divestitures and more in general, all the relevant matters of discussion by both the ordinary and extraordinary sessions of the shareholders' meetings.

## **7. MATTERS COVERED BY THE AGREEMENT**

Those contemplated in points 4 and 6 above.

## **8. MAJORITIES NEEDED TO REACH DECISIONS REGARDING THE ISSUES GOVERNED BY THE AGREEMENT**

The Shareholders Agreement Executive Committee approves its resolutions with the favourable vote of the majority of the shares transferred; the Shareholders Agreement Executive Committee can designate a trusted person to represent the shares in the shareholders agreement at the shareholders' meetings in order to vote according to its instructions. Whenever the decisions of the Shareholders Agreement Executive Committee are not voted unanimously, the dissenting participant shall have the right to freely vote at the shareholders' meeting.

#### **9. TERM, RENEWAL AND CANCELLATION OF THE AGREEMENT**

The agreement shall be valid until April 15, 2014 and shall be tacitly renewed for a period of one year except for withdrawal, which can be exercised between December 15 and January 15 prior to the expiration date. In case of withdrawal, the shares transferred by the withdrawing party shall be automatically offered pro quota to the other participants. The agreement shall remain in force, whenever it is possible, at every expiration date, to renew the agreement for a percentage of Pirelli & C.'s subscribed ordinary share capital of not less than 33%.

#### **10. PENALTIES FOR BREACH OF THE COMMITMENTS CONTAINED IN THE AGREEMENT**

They are not envisaged by the agreement.

#### **11. REGISTRATION OF THE AGREEMENT AT THE COMPANY REGISTRY**

The agreement is registered at the office of the Milan Companies Registry.

Milan, 19 January 2013













The illustrations contained in the three volumes of the Annual Report are all work of Liza Donnelly.

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In line with Pirelli's Green Sourcing Policy, the planning phase of this report included an analysis of the environmental impact of the materials used with the help of the supplier chosen, which has been certified by way of an environmental management system. Thanks to this approach, in order to carry out this project, we have used FSC-certified paper, recyclable PET, vegetable-based inks, and water-based paints. The final packages is made out of recyclable cardboard and polypropylene.

The results' documentation can be found online at [www.pirelli.com](http://www.pirelli.com)