



Vol. B



Vol. B

PIRELLI & C. S.p.A - Milan

**Report on corporate governance and
structure of share ownership
2011 Financial Year**



Report on Corporate Governance and structure
of share ownership 2011

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Sustainability Report 2011

Vol. C

Hans Magnus Enzensberger

HOW IS
LONG-TERM
SURVIVAL UNDER
CAPITALISM
POSSIBLE?

Hans Magnus Enzensberger

Born November 11, 1929 in Kaufbeuren, Germany. Educated at Universities of Erlangen, Freiburg, Hamburg and Paris. Ph.D. 1955. After a brief period of work in radio and publishing, he decided to embark on a free-lance career as a writer and has never since held a salaried position.

Spent more than ten years abroad in Norway, Italy, Russia, the United States and Cuba. Returned to Germany in 1969 and settled in Berlin and Munich. His main literary work is in poetry and essay, supplemented by excursions into theatre, film, opera, radio drama, reportage and translation, with one or two novels and several books for children thrown in.

Founder of a quarterly called *Kursbuch* in 1965 and of a monthly, *TransAtlantik*, in 1980. From 1985-2005, Enzensberger has directed an imprint of his own, *Die Andere Bibliothek*, published in Frankfurt, offering a book of his choice every month.

His own work has been translated extensively into more than forty languages.

How is long-term survival under capitalism possible?

Giants too are mortal. Pan American, Woolworths, Kodak, AEG, Enron, Lehman Brothers – not one of these firms was saved by their riches, their reputations, their world-famous brand names. Bankruptcies are part and parcel of the economic system. As far back as 1942 the famous economist Joseph Schumpeter used to impress on his students: “This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in.”

If that is the case, how did a small rubber factory founded 140 years ago in Milan do better than merely survive this crazed dynamic? How could this firm grow steadily to become a global corporation?

I don't know, for I am not an expert, so several suppositions will have to suffice by way of an answer.

Firstly, the leaders of such a company must, like experienced boxers, have good footwork, that is, they must be mobile and must anticipate the moves of their opponents.

Secondly, good nerves are essential. Persistence and powers of observation are also part of the make-up of those who survive.

Thirdly, flexibility does not mean short-term thinking. Quite the contrary. Those who have an eye only on the next quarterly report will not last long. And by the way, these three rules also apply at the smallest level, for example sole traders, and that includes artists, film directors, composers or writers.

(Translation by Geoffrey Mulligan)

Wie ist es

~~Ob es möglich ist~~, mitten im Kapitalismus
längere Zeit zu überleben? —————

[Woolworth,

└ Auch Giganten sind sterblich: Pan American, Kodak, AEG,
Eaton, Lehman Brothers... (W Reichtum, ihre Reputation, ihr
Weltbekanntes Markenname hat keine diese Firma vor
dem Untergang bewahrt. - Pleiten gehören zum Betriebsystem.

Joseph Schumpeter hat seinen Leuten schon 1942 gesagt:

"Der Prozess der stetigen Zerstörung ist das für den Kapital-
ismus / wesentliche Faktum. Darin besteht er und darin
auch zu jeder des Kap. Gebilde leben."]

Wenn das so ist, wie hat denn eine kleine Gummitabrik

→ was kann sie 1872 überleben können? —————

→ Einspruch!]

Ich weiß es nicht; Denn ich bin kein Experte. Deshalb unpräzise
Mitte mit ein paar Vermutungen begnüge. (1) Die Leute, die
einen solchen Kurs zu führen, müssen gute Fingerspitzen haben (wie
erfahrene Boxer), d. h. sie müssen beweglich sein und ihr Risiko
zu verkörpern. (2) Gute Nerven, Beobachtungsgabe (de Kontinuum)
und Gehirne Beharrlichkeit gehören zur Grundausbildung.]

(3) Flexibilität heißt nicht: kurzfristiges Denken. Im Gegenteil!
Wer nur auf den nächsten quartaly report schaut, wird nicht lange
durchhalten.]

Diese drei Regeln gelten übrigens auch im ^{kleinsten} Maßstab,
z.B. für Ein-Mann-Unternehmer — zu denen gehören die
Komponisten, die Maler, die Regisseure — und auch die
Schriftsteller.

Muritzmann

An Executive Summary of the Report on Corporate Governance and the Structure of Share Ownership is provided below to give an outline 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) a consolidated practice of disclosing the choices and the corporate decision-making processes and 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.

The governance system is formally defined in the Ethical Code, 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 second consecutive year in the framework of the World Finance Corporate Governance Award 2012. Furthermore, in December 2011, Governance Metrics International (GMI), confirmed the 10/10 opinion in relation to the PIRELLI corporate governance in the home market (the last Country Ranking conducted in September 2010 assigned Italia an average rating of 5.25/10) and attributed an 8/10 opinion in relation to the Global Market, and representing the best ranking recorded by Italian companies. In this regard, it is important to observe that among the forty companies assessed in Italy in December 2011: (i) only two companies (one of which was PIRELLI) were assigned a score corresponding to 10/10 in relation to the Home Market and (iii) only three companies (which also included PIRELLI) were assigned a score corresponding to 8/10 in relation to the Global Market.

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 20 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 (namely, the Board Members Franco Bruni, Elisabetta Magistretti, Pietro Guindani and Francesco Profumo).

The following persons fell from office during the 2011 financial year: (i) prof. Francesco Profumo fell from office on November 16, 2011 and accepted the office as a Minister of the Italian Republic and (ii) Enrico Tommaso Cucchiani fell from office on December 16, 2011 following his acceptance of other appointments.

In the meeting held on March 1, 2011, the Board of Directors appointed the Giuseppe Vita to substitute Mr. Cucchiani, pursuant to Article 2386 of the Italian Civil Code; in the same meeting, the Board of Directors appointed the Ms. Manuela Soffientini to substitute Prof. Profumo (selected from the minority list), based on the proposal made by the Appointments and Succession Committee. In this last case, even though the Appointments and Succession Committee is responsible for defining the candidates to be submitted to the Board to co-opt the person concerned when an independent Board Member is to be substituted, the Committee deemed it appropriate to involve Assogestioni¹ to identify the candidate to be submitted to the Board in order to substitute Prof. Profumo, since Prof. Profumo was a Board Member elected from the list presented by institutional investors under the auspices of Assogestioni. The latter proposed a short-list of two names to the Committee from which the Committee decided to propose Ms. Manuela Soffientini to the Committee, also considering the opportunity of further enhancing the gender diversity within the Board and, as has been said, Ms. Manuela Soffientini was appointed in the meeting held on March 1, 2012. 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.

The cited Board Members appointed by the Board of Directors will fall from office, as required by law, with the meeting convened to approve the 2011 Financial Statements that, accordingly, will be called to resolve their confirmation in office.

¹ Assogestioni is the representative association of the Italian investment management industry

EXECUTIVE DIRECTORS

The Board appointed Marco Tronchetti Provera as Chairman and Managing Director in the meeting held on April 21, 2011.

A senior management coordination function named the Executive Office was established during the financial year, in conjunction with the approval of the "new" Industrial Plan with an outlook extending to 2015 and the review of the 2012-2014 Targets; the Executive Office is responsible for examining the entire production process and comprises the Managing Director (CEO), Marco Tronchetti Provera and the General Manager (COO), Francesco Gori, with a special focus, with reference to the former, in relation to achieving the leadership position in the car business premium segment and, with reference to the latter, to developing the profitability and cash flow of the other businesses. Furthermore, the CEO and Chairman of the Executive Office assures the overall coordination of the Business Units and the Regions by availing of the Central Functions in order to assure the necessary rapidity in implementing the corporate strategies.

INDEPENDENT DIRECTORS

The Board of Directors is characterised by a number of Independent Directors who represent the absolute majority of its members since 2006.

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 eleven independent Board Members at the Date of the Report, while a further seven 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, all the more so, 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; in particular, the composition of the latter reflects the mix of expertise and the presence of executive, non-executive and independent Directors of the Board of Directors.

Lastly, all the 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 2011 financial year precisely to facilitate a constant improvement of the Board reporting process.

The Lead Independent Director then organised three meetings during the 2011 financial year involving only the Independent Directors to examine in greater detail matters relating to the Company's corporate governance system, confirming their special focus on the Board of Directors' self-evaluation system and the remuneration mechanisms, as has now become accepted practice.

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 5 Board Members, the majority of whom are non-executive (2 Independent Directors). Two Executive Officers with Strategic Responsibilities also sit on the Strategies Committee.

The Strategies Committee was composed of the following persons at the Date of the Report, considering the resignation of Prof. Francesco Profumo:

- ▶ Marco Tronchetti Provera (Presidente);
- ▶ Franco Bruni;
- ▶ Vittorio Malacalza;
- ▶ Renato Pagliaro;
- ▶ Carlo Secchi;
- ▶ Francesco Chiappetta;
- ▶ Francesco Gori

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 "new" Self-Regulatory Code of the Italian Stock Exchange (Borsa Italiana) dated December 2011; in fact, the version of the Self-Regulatory Code dated 2006 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 (Presidente);
- ▶ Annamaria 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.

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 Company's 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 five members, who are exclusively independent based on the more rigorous approach recommended in the "new" Self-Regulatory Code of the Italian Stock Exchange (Borsa Italiana) dated December 2011; in fact, the 2006 version of the Self-Regulatory Code included a recommendation that this Committee should only be composed of non-executive Directors, in which "only" the majority were to be Independent Directors.

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

- ▶ Carlo Secchi (Presidente);
- ▶ Franco Bruni;
- ▶ Paolo Ferro-Luzzi;
- ▶ 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 Committee;
- ▶ Sustainability Steering Committee;
- ▶ Product Committees;
- ▶ Business Unit and Region Performance Reviews;
- ▶ Organisation and People Review Committee.

SUCCESSION PLANS

First of all, the newly established Appointments and Succession Committee examined the corporate processes relating to the identification, management and development of the "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 development initiatives for 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 the Company (i) to monitor the key resources in the Company 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.

In the early part of 2012, the Appointments and Succession Committee appointed a company specialising in this area and part of a global network to support PIRELLI in the Governance of the top and senior management succession plans.

In particular, during 2012, with the support of the appointed consultancy company, PIRELLI intends to identify the key functions/areas for further business development and to verify the potentials for internal growth to then eventually, in a subsequent phase, monitor the market of Senior Executives with special talents, in order to identify profiles of potential interest for the Group.

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 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 responsible 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.

ETHICAL CODE – CODE OF CONDUCT

The Ethical Code outlines the general principles adopted as a reference for the performance and conduction of business within PIRELLI; the Ethical Code 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 Ethical Code, in the belief that business success cannot be separated from ethics in business.

In particular, the Code of Conduct contain an "operative" statement of the principles contained in the Ethical Code and establish rules, for the whole Group, designed to prevent the creation of an environment favourable to committing offences in general.

The Ethical Code and the Code of Conduct 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 Paolo Domenico Sfamini and by Maurizio Bonzi, the Internal Audit Function Manager and the Internal Control Officer.

AUDIT COMPANY

The statutory audit activities are performed by a company appointed by the Shareholders' Meeting from among the companies listed in the special register kept by Consob. 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 the Chief Financial Officer Francesco Tanzi, 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 rigorous 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 of 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 organisational 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 Board of Statutory Auditors supervises the following aspects: (a) the financial reporting process; (b) the efficiency of the internal control system, the internal audit system and the risk management system; (c) statutory audit of the annual accounts and the consolidated accounts; (d) 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 Governance, in addition to participating in all the Board of Directors' meetings and the Shareholders' Meetings. Furthermore, Paolo Domenico Sfameni, 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 April 21, 2009 resolved to renew the Board of Statutory Auditors for the 2009 - 2011 financial years, by appointing Enrico Laghi, Paolo Gualtieri and Paolo Domenico Sfameni as Statutory Auditors and appointing Luigi Guerra and Franco Ghiringhelli as Alternate Auditors, accordingly, the foregoing fall from office after completing their mandate with the Shareholders' Meeting convened to approve the 2011 Financial Statements.

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 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.

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 also intensified the dialogue with the "Ethical investors" during 2011 by participating in international conferences concerning governance and sustainability.

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 Decree 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 meeting in first or only 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 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.

Report on Corporate Governance and Structure of Share Ownership 2011 Financial year

GLOSSARY

Shareholders' Meeting to approve the Financial Statements for 2011:

means the Shareholders' Meeting convened to approve the Financial Statements as of December 31, 2011;

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;

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, 2012 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);

2011 financial year:

indicates the financial year closed as of December 31, 2011;

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;

Prelios:

indicates Prelios S.p.A. (formerly PIRELLI & C. Real Estate S.p.A. – "PIRELLI RE"), with registered office in Milan, Tax Code and registration number in the Milan Register of Companies under No. 02473170153;

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;

Company:

indicates PIRELLI & C.;

Company Bylaws:

indicates the Company Bylaws of PIRELLI & C., available on the PIRELLI Internet website and detailed at the end of this report;

Unified Finance Law (TUF):

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

**PIRELLI WAS
DECLARED THE**

**“BEST
CORPORATE
GOVERNANCE
IN ITALY”**

**FOR THE SECOND
CONSECUTIVE YEAR
IN THE FRAMEWORK
OF THE
WORLD FINANCE
CORPORATE
GOVERNANCE
AWARD 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 for the 2011-2013 three-year period.

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 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) a consolidated practice of disclosing the choices and the corporate decision-making processes and 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 sus-

tainable 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 Ethical Code, 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 has declared the "Best Corporate Governance in Italy" for the second consecutive year in the framework of the World Finance Corporate Governance Award 2012. Furthermore, in December 2011 Governance Metrics International (GMI) confirmed the 10/10 score for PIRELLI'S corporate governance on the home market (Italy was assigned an average score of 5.25/10 in the last Country Ranking in September 2010) and was attributed a score of 8/10 compared to the Global Market, representing the maximum score recorded by Italian companies. In this regard, it is important to observe that in December 2011, among the forty companies assessed in Italy: (i) only two companies (including PIRELLI) obtained a score that corresponded to 10/10 in relation to the Home Market and (iii) only three companies (including PIRELLI) obtained a score corresponding to 8/10 compared to the Global Market.

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 12, 2012

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.

In this regard, it is important to note that the ordinary Shareholders' Meeting held on April 21, 2011 resolved a voluntary reduction of the share capital without annulling shares that was completed on August 29, 2011. The share capital reduction formed part of the transaction to assign the shares of Prelios (formally PIRELLI RE) that the Company executed during the 2010 financial year and representing its natural completion.

In fact, as is known, the assignment of Prelios shares was performed by allocating to PIRELLI & C. shareholders almost all of the ordinary Prelios shares held by the Company and executed by reducing the share capital, the actual amount of which was determined by the extraordinary Shareholders' Meeting of PIRELLI & C. held on July 15, 2010 at a value equivalent to the fair value of the Prelios shareholding to be assigned (corresponding to euro 178,813,982.89), in turn, determined on the basis of the official price of the Prelios shares (corresponding to euro 0.367) determined on July 14, 2010, the trading day prior to the date of the Shareholders' Meeting that resolved the assignment.

The assignment was executed on October 25, 2010, in accordance with Article 2445, paragraph 3 of the Italian Civil Code, after the time limits laid down by law had expired, and in compliance with the accounting provisions, based on the official stock exchange price of the Prelios shares determined precisely on October 25, 2010 (euro 0.4337); PIRELLI & C. restated in the financial statements the liabilities generated by the assignment from euro 178,813,982.89 to euro 211,312,328.01, with a negative change in Shareholders' equity as a balancing entry amounting to euro 32,498,345.12, reported in the Financial Statements under "Reserve for assignment of Prelios S.p.A. shares". At the same time, in relation to the assignment of the Prelios shares, PIRELLI & C. reported a loss in the Income Statement amounting to approximately euro 118.3 million, corresponding with the difference between the value of liabilities, as redetermined above, and the net book value of the Prelios shares.

Accordingly, in order to realign the share capital with the Shareholders' equity it was found appropriate to reduce to zero the Reserve for assignment of Prelios shares, as has been said, corresponding to a negative amount of euro 32,498,345.12, by the voluntary reduction of the share capital for an equal amount.

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 effect 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 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.

- 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.
- 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) (hereafter, the "Agreement") (as of December 31, 2011), 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 management² 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) **Change of control clauses and statutory provisions concerning a public purchase offer.**

² 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.

Change of control clauses

There is no party that can exercise control over PIRELLI & C., either directly or indirectly, 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 incorporated in 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 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 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.

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 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) envisages 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.

- l) **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.³

³ The amendment to Article 5 of the Company Bylaws was approved during the 2011 financial year (Shareholders' Meeting to approve the Financial Statements closed as of December 31, 2010), to eliminate the reference to the power granted by the Extraordinary Shareholders' Meeting held on May 7, 2003 to issue up to a maximum of 100,000,000 ordinary shares, in one or more operations, within April 30, 2008, to be assigned to Executives and the middle management in the company and in its subsidiaries and in the companies controlled by the latter, in Italy and abroad, and the reference to the circumstance that the Board of Directors' Meeting held on February 25, 2005 had resolved, as a partial execution of the power conferred on it, to increase the share capital by a maximum par value of Euro 15,725,496.50, by issuing a maximum of 54,225,850 ordinary shares with a par value of Euro 0.29 each at a price of Euro 0.996 each, including Euro 0.706 as a share premium, to be reserved for subscription to Executives and the middle management in the Company and in its subsidiaries or in the companies controlled by the latter, in Italy and abroad.

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 0.07% of the whole share capital and 408,342 savings treasury shares corresponding to 3.3% of the saving shares capital and corresponding to 0.084% of the whole share capital.

m) Directors' indemnity in the case of resignation, dismissal or termination of the employment relationship following a public purchase offer⁴

PIRELLI has a policy not to enter into agreements with Directors, 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 example, 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 is equal to 3 annuities of the gross annual payment, meaning the sum of (all the fixed annual gross payments for the positions held; average annual MBO received during the mandate; End of Mandate Indemnity (TFM) on the foregoing amounts).

In this regard, the reader is referred to the "Remuneration Report" for the 2011 financial year published on the PIRELLI Internet website. It is important to note that the updated Remuneration Report referred to the 2012 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.

n) 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).

⁴ 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.

**THE BOARD OF
DIRECTORS IS
EMPOWERED
TO ASSUME
THE MOST
IMPORTANT
DECISIONS IN
ECONOMIC /
STRATEGIC
TERMS**

PIRELLI declared its compliance with the new version of the Self-Regulatory Code (December 2011) in the Board Meeting held on March 12, 2012, the new version is published on the following website: www.borsaitaliana.it.

The Report was also written on the basis of the experimental format distributed by the Italian Stock Exchange (Borsa Italiana) in February 2008 and subsequently updated in February 2010 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 2011 financial year, still refers to the principles and recommendations contained in the March 2006 version of the Sub-Disciplinary Code.

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 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 Direc-

tor, 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.

In particular, the participation of the Chief Operating Officer (General Manager) and the other Executives with strategic responsibilities (General Counsel and the General and Institutional Affairs Manager; the Management Control Manager, the Administration and Finance Manager and the Responsible Officer) in the Board of Directors' meeting is 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.

4.1 APPOINTMENT AND REPLACEMENT OF DIRECTORS

Since 2004, the Company Bylaws⁵ envisage that the Board is to be appointment 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 in first call (or only call) 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.

The Company Bylaws acknowledge the right to present lists of shareholders who, alone or together with other shareholders, hold a total number of shares representing at least 2% of the share capital entitled to vote in the Ordinary Shareholders' Meeting, 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 1.5% of the share

⁵ Article 10 of the Company Bylaws.

capital entitled to vote in the Ordinary Shareholders' Meeting referred to the 2012 financial year)⁶ 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:

- ▶ a) 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;
- ▶ b) 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 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 Directors, as envisaged by the applicable laws and regulations, in possession of the legal requirements for independence remain in office.

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.

⁶ Refer to Consob Resolution No. 18083 dated January 25, 2012.

The Board of Directors was composed of 20 Directors⁷ 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 64 and with an average term in office corresponding to approximately 5 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 Profumo⁸).

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 capital⁹) and one from a group of institutional investors¹⁰ (who obtained 15.6% of the votes of the voting capital¹¹). 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.

7 The Board was composed of 18 Directors as of December 31, 2011, after the following Directors had resigned: Prof. Francesco Profumo resigned on November 16, 2011 after being appointed a Minister of the Italian Republic and Enrico Tommaso Cucchiani resigned on December 16, 2011 after accepting new positions in other companies. The number of Directors was returned to 20 in the Board of Directors' meeting held on March 1, 2012 that appointed Giuseppe Vita and Ms. Manuela Soffientini as Board Members.

8 Refer to preceding note.

9 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.

10 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 Pensio 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).

11 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.

The updated version of the curriculum vitae of each Director are published on the PIRELLI Internet website.

The following persons fell from office during the 2011 financial year: (i) prof. Francesco Profumo on November 16, 2011, who accepted an appointment as a Minister of the Italian Republic and (ii) Enrico Tommaso Cucchiani on December 16, 2011 after having accepted other positions.

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 1, 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 cited Directors appointed by the Board of Directors will fall from office, as required by law, with the Shareholders' Meeting convened to approve the 2011 Financial Statements that, accordingly, will be called to resolve the confirmation of the appointment.

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 Code¹², confirming the Policy¹³, adopted by the Board of Directors in 2007¹⁴, 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 were invited to examine the cited policy when the Board of Directors was to be reappointed.

In the meeting held on March 12, 2012 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 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 Report¹⁵.

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 2012 financial year:

- ▶ March 12, 2012: Board of Directors' meeting to examine the draft financial statements and the consolidated financial statements as of December 31, 2011;
- ▶ May 10, 2012: Board of Directors' meeting to examine the interim report on operations as of March 31, 2012;
- ▶ July 26, 2012: Board of Directors' meeting to examine the half-yearly financial report as of June 30, 2012;
- ▶ November 7, 2012: Board of Directors' meeting to examine the interim report on operations as of September 30, 2012.

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

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.

By way of confirmation, it is important to note that the Board's self-evaluation process confirmed (as in the previous financial years) the Directors' complete satisfaction concerning the pre-Board meeting information process for the purpose of passing informed resolutions.

¹² Self-Regulatory Code: Application criterion 1.C.3.

¹³ The cited Policy is annexed to the Report and is also available on the Company's Internet website.

¹⁴ 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. The document that contains the Policy concerning the maximum number of offices that a Company Director can hold in other companies is provided at the end of this Report.

¹⁵ Self-Regulatory Code: Application criterion 1.C.2.

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 Directors¹⁶:

- ▶ examines and approves the strategic, industrial and financial plans of the Company and of the Group;
- ▶ 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;
- ▶ 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 7 times during the 2011 financial year (including 6 meetings after the Board was reappointed), each meeting had an average duration of approximately one hour and forty-five minutes and the percentage attendance of the Directors was almost 90% and the percentage attendance of the Independent Directors was almost 95%.

The Lead Independent Director attended all the Board of Directors' meetings. 2 Board Meetings were held in 2012 at the Date of the Report.

**THE BOARD
DEFINED
THE 2011
BUSINESS PLAN
AND APPROVED
THE INDUSTRIAL
BUSINESS PLAN
WITH AN
OUTLOOK
EXTENDED
TO 2015**

4.4.1 Evaluation of the general trend of operations¹⁷ 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 law¹⁸ and the Company Bylaws¹⁹.

More in particular, during the 2011 financial year the Board:

- ▶ defined the 2011 Business Plan and approved the Industrial Business Plan with an outlook extended to 2015, taking into account the Group's positive trend, and updated the 2012-2014 targets 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 occasions, 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 2011 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 system²⁰

During the meeting held on April 21, 2011, after its complete renewal, the Board of Directors confirmed the Corporate Governance system that had been adopted by the previous Board of Directors, as described in this Report.

More in particular, the Board, also:

- ▶ confirmed compliance with the Self-Regulatory Code (March 2006 version) issued by the Italian Stock Exchange (Borsa Italiana) and identified the Board of Directors' responsibilities, and subsequently, in the meeting held on March 12, 2012 verified their consistency with the new version of the Self-Regulatory Code to which the Board declared its compliance in the same meeting;
- ▶ appointed the Chairman and the Managing Director and the Deputy-Chairmen of the Board of Directors;

- ▶ identified the Director appointed to supervise the operation of the internal control system and confirmed the Officer responsible for the Internal Control function. In this regard, during the 2011 financial year, the Board approved the review of the remuneration "mix" referred to the Officer responsible for the Internal Control function, reducing the incidence of the variable component to achieve an alignment with the best practices concerning the remuneration of the control functions;
- ▶ acknowledged the Company's organisational system;
- ▶ appointed the Lead Independent Director;
- ▶ established the Advisory Committees and appointed their members;
- ▶ confirmed the establishment of the Supervisory Board, appointed its members and established their fees;
- ▶ confirmed the Director designated to prepare the Company's accounting documents;
- ▶ confirmed the identification of the Directors with strategic responsibilities;
- ▶ 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.

During the governance tools review and to adapt to the new regulatory provisions, the Shareholders' Meeting held in April 2011 approved some amendments to the Company Bylaws, at the Board's proposal, to adapt the Bylaws to the provisions of law introduced by Legislative Decree No. 27/2010 that implemented Directive 2007/36/EC in Italian law, aimed at facilitating participation in Shareholders' Meetings by the shareholders of listed companies and by Legislative Decree No. 39/2010 concerning the implementation of Directive 2006/43/EC regarding the statutory auditing of annual accounts and consolidated accounts.

Furthermore, the Board approved the changes to the Organisational Model 231 deemed appropriate to take into account the introduction of environmental offences among the presumed offences provided for under corporate liability, pursuant to Legislative Decree No. 231. In particular, a specific internal control scheme was introduced concerning the "obligations for environment-related activities" that summarises

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

18 Article 150 of the Unified Finance Law (TUF).

19 Article 11 of the Company Bylaws.

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

the procedures and accepted practices already in place within the PIRELLI Group.

In this regard the reader is referred to the section: Ethical Code, 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, 2010, an analogous activity was performed during 2012 in relation to the Financial Statements as of December 31, 2011.

The Board of Directors discussed the updated status concerning the legal action involving former employees of the Security Department that was kept under constant scrutiny by the Board of Directors, by the Committee for Internal Control, Risks and Corporate Governance, together with the Board of Statutory Auditors and the Supervisory Board.

Lastly, it is important to note that during the session held on March 12, 2012, 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 Group²¹.

4.4.3 Remuneration of Directors invested with special offices²²

Following the appointment of the "new" Board of Directors during the 2011 financial year 2011, the Board examined and approved the proposals relating to the remuneration of Directors invested with special offices (Chairman and Managing Director and Deputy-Chairmen), further to the proposal by the Remuneration Committee, in addition to apportioning the overall remuneration assigned by the Shareholders' Meeting.

Moreover, the Board established the annual targets relating to the incentive plans for the Chairman and Managing Director, the Directors with strategic responsibilities and as customary, performed the examination and the final summary of the annual incentives and targets referred to the previous financial year.

Lastly, in the meeting held on March 12, 2012 the Board 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.

It is important to note that the remuneration due and payable to the Chairman and Managing Director (Marco Tronchetti Provera) was restructured during the 2012 financial year following the Chairman's waiver of a significant part (approximately 20%) of the fixed annual gross remuneration established for the offices held in PIRELLI and attributing greater incidence to the variable components.

In particular the fixed component, therefore, was restructured up to the end of the mandate, as follows:

- ▶ a fixed gross fee amounting to euro 900 thousand, in addition to the fee received as the Managing Director (50 thousand euro gross) was established for the office held in PIRELLI & C.;
- ▶ a fixed gross fee amounting to euro 2 million and a variable fee was attributed for the office held in PIRELLI Tyre.

It is important to note that as regards the incidence of the variable component, if the annual target objectives envisaged by the MBO 2012, 2013 and 2014, as well as the fixed target objectives established by the LTI 2012/2014 Plan are achieved, then the structure of the Annual Total Direct Compensation for the Chairman and Managing Director would be as follows:

- ▶ fixed component: 40%;
- ▶ variable component: 60% of which
 - annual variable component 23% of the Annual Total Direct Compensation (amounting to approximately 38% of the total variable component);
 - long-term variable component (LTI Premium from coinvestment and net LTI Premium) 37% of the Annual Total Direct Compensation (equal to approximately 62% of the total variable component).

In this regard, the reader is referred to the updated Remuneration Report for the 2012 financial year (that includes the Remuneration Policy referred to the 2012 financial year and the Report referred to the 2011 financial year). The Remuneration Report referred to the 2012 financial year will be available on the PIRELLI Internet website no later than 21 days preceding the Shareholders' Meeting scheduled for May 10, 2012.

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

²² Self-Regulatory Code: Application criterion 1.C.1., sub-section d).

4.4.4 Transactions of significant strategic, economic, equity or financial importance²³

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 Italian²⁴ and also foreign companies which are not listed and are subject to management and coordination activities by PIRELLI & C.²⁵, 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 2011 financial year.

More in detail, the Board of Directors approved the transaction to reduce the share capital described in greater detail in paragraph 2 sub-section a).

The Board received updates concerning the entry of PIRELLI in Russia, and in particular, concerning the agreement with Sibur Holding (i) to transfer the Kirov plant to the joint-venture to be established between PIRELLI and Russian Technologies, (ii) concerning the commitment to transfer other assets which it is envisaged can enable the joint-venture to achieve a production of 11 million units within 2014.

In this regard, it is important to remember that during 2010, PIRELLI, Russian Technologies and Sibur Holding had reached an agreement to develop joint business activities in the sectors of tyres, steel cord and in the supply and high-technology production of synthetic rubber derivatives in Russia.

In particular, with regard to the tyre sector, the agreement reached lays the foundations to initiate a joint rationalisation and reorganisation process of the tyre business activities headed by Sibur Holding, a company that represents one of the major Russian groups in the petrochemical sector. In fact, the agreements envisaged a reorganisation process designed to select the assets of Sibur Russian Tyres (also including the Kirov production facility). The Board of Directors then approved the renewal of the loan in favour of Prelios (formerly PIRELLI RE) amounting to 160 million euro up to July 2017, since also representing a significant transaction with a related party.

²³ Self-Regulatory Code: Application criterion 1.C.1., sub-section f).

²⁴ 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 and at the end of the Report.

²⁵ 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.

The Board approved the launch of an American Depository Receipt (ADR) Level 1 programme for the United States market.

In order to seize the best financing opportunities to provide continuous support for the business growth in a context of volatile financial markets the Board of Directors approved the issuance of non-convertible bonds up to a maximum face value of 800 million euro (or corresponding counter value in other currencies), also to be placed in several tranches on international markets within the end of 2012, and intended exclusively for qualified investors.

It is important note that the "procedure regarding information flows to Directors and Auditors"²⁵ envisages general 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 Code²⁶.

The Board deemed it appropriate to confirm the structure of the self-evaluation process adopted in the past, also with reference to the 2011 financial year, based on a proposal by the Committee for Internal Control, Risks and Corporate Governance, and taking into account the positive experience of the previous years.

The self-evaluation process was performed with the support of a leading consulting firm (Key2People) that assisted the Committee for Internal Control, Risks and Corporate Governance to prepare the evaluation methods and to report the respective results.

In line with the most widely tested accepted practices, the self-evaluation process was implemented on the basis of direct interviews with individual Board Members preceded by a written questionnaire structured with 25 statements in relation to which the Board Member could express his/her own level of agreement/disagreement on a scale from 1 to 5.

²⁶ Self-Regulatory Code: Application criterion 1.C.1., sub-section g).

Fig. 1

Respect



The self-evaluation process has confirmed the Board Members' full satisfaction concerning the decision-making processes of the Board and the Committees deemed to be of high quality. In particular, the high level of harmony among the Directors and between the Board and the Key Management concerning Company strategy; the constant monitoring of the operational and financial performance and the importance assigned to the control processes performed with the support of the Committees contribute effectively to achieving this result, even though the Board is in its first year.

The Board Members expressed their satisfaction concerning the level of involvement in adopting and developing the Industrial Plan and the need for greater awareness concerning some strategic aspects emerged (for example: R&D, Brand, Marketing), also to be achieved through greater involvement of the Key Management.

The consolidated practice of the Board's interaction with Directors who have strategic responsibilities and that participate actively in the Board's Meetings was greatly appreciated; this is deemed useful to enable the Board to achieve a better understanding of the abilities of the persons managing the company, as well as to receive support in the decision-making process. An increasing involvement of the Key Managers is to be hoped for this reason and the need to further extend the Board's knowledge of the Company's organisation emerged.

The analysis also identified a high level of satisfaction concerning the completeness of the activity performed by the Committees and, as in the past, a unanimous appreciation was confirmed for the work performed by the Lead Independent Director.

The Board's size, in numerical terms, then led to expressing the need for a more structured and continuous induction activity.

The self-evaluation indicated an overall satisfaction with regard to the reporting systems, although expressing the need for greater simplification of the representations.

Lastly, the mix of skills and expertise and the Board's composition were very greatly appreciated.

4.4.7 Article 2390 of the Italian Civil Code

Article 10, last paragraph of the Company By-laws 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 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

PIRELLI initiated a review during the financial year (a) of the functioning procedures; (b) the processes and (c) the top management relations of the organisation that will accompany the Group to "execute" the Industrial Plan, in conjunction with the approval of the "new" Industrial Plan with an outlook extending to 2015 and the review of the 2012-2014 Targets.

Moreover, the organisational structure envisages three organisational entities: Functions, Business Units and Regions/Countries.

The Functions support the activities engaged in by the Business Units and the Regions supervise some key processes, for example: the operations, supply chain, quality and purchases.

While the Business Units define the strategy of a specific business on a global level, with particular focus regarding the allocation of the production and the product in relation to the expected profitability and to supervise the Marketing processes.

While the Regions and Countries assure the implementation, at a local level, of the strategies defined by the Business Units and Functions, adapting them to the local scenario.

In addition, the Regions and Countries contribute to defining the strategy by transferring to the centre information and reports concerning specific opportunities.

In particular, a top management coordination activity has been established to overview the entire production structure, referred to as the Executive Office and composed of the Managing Director (CEO), Marco Tronchetti Provera and the General Manager (COO), Francesco Gori with the former having a special focus on achieving the leadership position in the premium segment of the car business and the latter having a special focus on the development of profitability and cash flow of the other businesses.

This will enable an organisation to be developed that is more integrated and reactive by streamlining the structure and simplifying the management mechanisms of committees and business meetings.

All the functions report to the Executive Office with the sole exclusion of the functions which report directly to the Chairman, thereby assuring consistent policies and plans of action among the various Business Units and the various Regions.

The following continue to report to the Chairman: General Counsel; Investor Relations; Communication and Media Relations; Culture; whereas the following report to the Executive Office (i) under the direct responsibility of the CEO: Products and Environmental Services Business Unit; Car Business Unit; PZero Fashion; Eu-

rope Region; Russia Region; and (ii) under the direct responsibility of the COO: Truck Business Unit; Motorcycle Business Unit; Agro and Special Vehicles Business Unit; Steelcord Business Unit; Latam Region; Apac Region; Mea Region; Nafta Region.

The Administration and Finance; Management Control; Human Resources and Organisation; Image & Brand Extension; Quality; Product and Materials Quality; Operations and Industrial Quality; Purchases; Logistics; IT & Business Process Improvement functions give their support to all the business functions.

Furthermore, the C.E.O., as Chairman of the Executive Office, assures the overall coordination of the Business Units and the Regions by availing of the Central Functions in order to guarantee the necessary rapid implementation of the corporate strategies.

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 Gori (General Manager); Francesco Chiappetta, lawyer (General Counsel and Chief of General and Institutional Affairs); Francesco Tanzi (Chief Financial Officer and Responsible Officer) and Maurizio Sala (Chief Management Control).

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 law²⁷ and by the Company Bylaws²⁸.

²⁷ Article 150, paragraph 1 of the Unified Finance Law (TUF).

²⁸ Article 11 of the Company Bylaws.

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 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 concerning the Company's re-

ality and dynamics and in compliance with the recommendations of the Self-Regulatory Code²⁹ and with what is now a consolidated practice within the Company.

Moreover, after the Board of Directors was reappointed during the 2011 financial year, the Company initiated a specific orientation plan (so-called induction plan) for the new Directors elected at the date the Board of Directors was reappointed.

In particular, a meeting of the Independent Directors (including the newly elected Directors) was organised with the General Manager for an overview of PIRELLI's business areas and to examine in detail the features and the specific aspects of the tyre market, the product segments of interest to PIRELLI and the geographical areas where PIRELLI operates.

In addition, the newly appointed members of the Committee for Internal Control, Risks and Corporate Governance attended independent and specific induction meetings with the Designated Internal Control Officer, with the Risk Officer and with the Compliance Manager; while the Remuneration Committee (completely renewed following the Board of Directors' reappointment) met, also informally, to initiate a structured detailed study of the Remuneration Policy, and in general, to understand the principal drivers, and in particular, to analyse the Remuneration structure of the Chairman, the General Manager and the other Executives with strategic responsibilities.

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.

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 Code³⁰ for the purpose of performing the respective assessment, and, accordingly, a given Director cannot - as a rule - be deemed independent:

²⁹ Self-Regulatory Code: Application criterion 2.C.2.

³⁰ Application criteria 3.C.1. and 3.C.2.

**THE COMPANY'S
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ITS MEMBERS**

- ▶ a) 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.;
- ▶ b) if the Director concerned is or has been in the preceding three financial years, a prominent member³¹ 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;
- ▶ c) 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;
- ▶ d) 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., including the participation in corporate performance-based incentive plans, also based on share options;
- ▶ e) if the Director concerned was a Director of PIRELLI & C. for more than nine months over the last twelve years;
- ▶ f) if the Director concerned is an Executive Director in another company in which an Executive Director³² of PIRELLI & C. is a Director;
- ▶ g) 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 audit the accounts³³ of PIRELLI & C.;
- ▶ h) 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 assessed the applicability of the requirements of independence in the meeting held on April 21, 2011, 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 who were qualified as Independent at the date in their candidacy and in particular: Carlo Acutis; Anna Maria Artoni; Alberto Bombassei; Franco Bruni; Luigi Campiglio; Paolo Ferro-Luzzi; Pietro Guindani; Elisabetta Magistretti; Francesco Profumo (substituted by the Board Member Manuela Soffientini after his resignation); Luigi Roth and Carlo Secchi. In the meeting held on March 12, 2012, the Board of Directors confirmed that the cited requirements of independence were still applicable with reference to the Directors still in office³⁴.

A further seven³⁵ Board Members (the deputy-Chairman Vittorio Malacalza and the Board Members Gilberto Benetton; Giulia Maria Ligresti; Massimo Moratti; Renato Pagliaro; Giovanni Perissinotto and Giuseppe Vita) 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 59 with an average term in office that corresponds to approximately 4 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 Code³⁶.

31 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.

32 The Executive Directors of the Company issuing the Report are: the Chairman and Managing Director, Marco Tronchetti Provera and the Deputy Chairman, Alberto Pirelli.

33 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).

34 It is important to remember that Prof. Francesco Profumo, qualified as an independent at the date of his appointment resigned from office on November 16, 2011.

35 Enrico Tommaso Cucchiani who resigned from office on December 16, 2011 was qualified as a non-executive Director up to that date.

36 Self-Regulatory Code: Application criterion 3.C.5

4.7.1 Meetings of the Independent Directors

In line with the recommendations of the Self-Regulatory Code³⁷, the Independent Directors met 3 times during the 2011 financial year in the absence of the other Directors.

The Independent Directors examined in detail issues relating to the Company's corporate governance system confirming, as has become an accepted practice, their special attention to the self-evaluation system referred to the Board of Directors and to the remuneration mechanisms.

The Independent Directors examined some aspects relating to PIRELLI's entry in Russia in a meeting also extended to the other non-executive Directors and with the Chairman of the Board of Directors also in attendance.

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 recently established Appointments and Succession Committee and the Strategies Committee; in particular, the composition of the latter 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 Directors elected by the so-called minorities sit on at least one Committee.

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 Strategies Committee of which the Lead Independent Director is a member, and the Lead Independent Director has been constantly in contact with the Chairman of the Board of Directors, as in the past, also with reference to the 2011 financial year, precisely to achieve a constant improvement of the Board information process.

The Lead Independent Director also organised three meetings during the 2011 financial year involving only the Independent Directors, as mentioned previously, to examine in detail issues relating to the Company's corporate governance system, as has become accepted practice, confirming their special attention paid to the self-evaluation system of the Board of Directors and the remuneration mechanisms.

³⁷ Self-Regulatory Code: Application criterion 3.C.6.

**MARKET
TRANSPARENCY,
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AND CLEAR
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VALUES WHICH
ARE UPHELD
BY THE CONDUCT
OF THE COMPANY**

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"³⁸.

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 Black out periods³⁹), 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.

³⁸ These refer to F. Gori, F. Chiappetta, F. Tanzi and M. Sala. In this regard the reader is referred to the paragraphs "delegated bodies" and "Company organisation".

³⁹ The procedure relating to the black out periods is available on the Company's Internet website.

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 Governance⁴⁰, the Remuneration Committee; the Appointments and Succession Committee and the Strategies Committee.

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

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).

The Appointments and Succession Committee was composed as follows at the Date of the Report⁴¹:

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

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

40 This name was adopted from September 1, 2009 and substitutes the name "Committee for Internal Control and Corporate Governance".

41 The reader is referred to Table 4 for further details.

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 Independent 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, (i) of the C.E.O.; (ii) of the C.O.O.;
- ▶ 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.

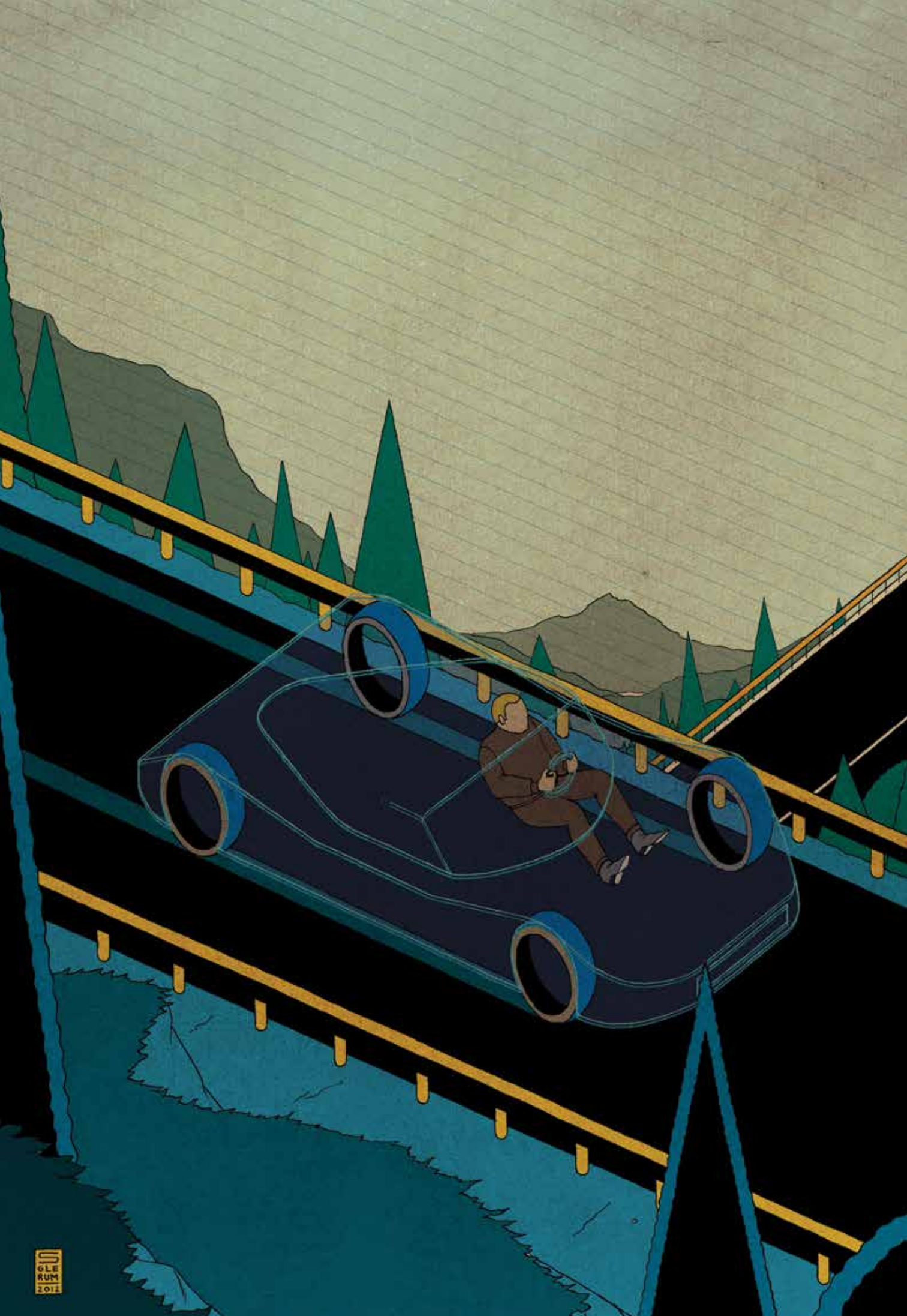
The Committee's meetings are convened by a notice, also sent by the Secretary, duly appointed by the Committee Chairman.

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.

Fig. 2

Transparency



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

The Appointments and Succession Committee met once during the 2011 financial year; the duration of the meeting was approximately 1 hour and 15 minutes. 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, with the support of the Senior Advisor Human Resources, the Committee endorsed the review (a) of the functioning arrangements; (b) the processes and (c) the management relations of the organisation that will accompany the Group to "execute" the Industrial Plan.

The Committee then examined the selection, development and training process of the so-called "talents" and the management training and focused on the management review process and the succession planning.

The Committee has already met once in the early months of 2012 to identify a company with expertise in this area and to subsequently appoint the company to support PIRELLI in the Governance of the top and senior management succession plans.

In this regard, the reader is referred to the "Succession Plans" section.

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.

The Strategies Committee is composed of 5 Board Members, the majority of whom are non-executive Directors (2 Independent Directors).

Two Executive Managers with strategic responsibilities are also members of the Strategies Committee.

The Strategies Committee was composed as follows at the Date of the Report, taking into account the resignation of Prof. Francesco Profumo⁴²:

- ▶ Marco Tronchetti Provera (Chairman);
- ▶ Franco Bruni;
- ▶ Vittorio Malacalza;
- ▶ Renato Pagliaro;
- ▶ Carlo Secchi;
- ▶ Francesco Chiappetta;
- ▶ Francesco Gori

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

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:

⁴² The Reader is referred to Table 4 for further details.

- 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 3 times during the 2011 financial year; the average duration exceeded one hour and thirty minutes 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.

In particular, the Committee endorsed the Industrial Plan guidelines with an outlook extending to 2015, the review of the 2012-2014 targets and the review (a) of the functioning arrangements; (b) the processes and (c) the top management relationships of the organisation that will accompany the Group to "execute" the Industrial Plan (the reader is referred to paragraph 4.5.2 "Company Organisation" for further details concerning PIRELLI'S organisation).

Lastly, the Committee examined in advance the project to enhance the presence in Argentina with a new plant to manufacture Truck radial tyres that aims to rebalance the Company's presence in South America.

The project envisages investments of approximately 300 million dollars starting from 2012 intended for the initial development phase that will be completed within 2014. A second phase of the project would entail additional investments of approximately 200 million dollars.

The first phase of the investment envisages a production capacity of approximately 700 thousand tyres per year and employing approximately 700 persons. The second phase would make it possible to achieve a potential production capacity, when fully operational, of approximately 1.4 million tyres per year and to employ approximately 1,200 persons.

The project aims to strengthen the leadership position already held by PIRELLI in South America and forms part of the strategy that in recent years has seen the progressive increase of the direct industrial presence on markets like Argentina, which have higher rates of development, in addition to competitive industrial costs in the framework of a regional logic that, inter alia, enables the effects associated with exchange rate fluctuations to be contained. In particular, the new plant would enable the increased demand for radial tyres to be satisfied in a country that has an economic growth that is attracting new investments by the automotive industry.

The new plant is expected to be built in 2012 and envisages the production of technologically innovative tyres which offer efficient mobility solutions, in terms of performance, safety, eco-sustainability and economic operation. The product lines foreseen will exploit the state-of-the-art SATT technology that permits the product's useful working life to be extended, optimising its levels of wear and improving driving precision.

The Committee met once during the early months of the 2012 financial year.

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, in fact, the 2006 version of the Self-Regulatory Code 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 Report⁴³:

- ▶ Carlo Acutis (Chairman);
- ▶ Annamaria 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:

- ▶ 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 bodies and for General Managers, and in a cumulative form in the case of Executives with strategic responsibilities:
 - ▶ a) provides an adequate representation of each of the items comprising the remuneration;
 - ▶ b) 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

⁴³ Readers are referred to Table 4 for further details.

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.

It is important to remember that the Board of Directors then 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 Auditors⁴⁴ 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 Code⁴⁵ 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 register⁴⁶.

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 authority⁴⁷ to access company information and the functions relevant to performing its duties, availing of the Secretary's support for this purpose.

9.4 ACTIVITIES DURING THE FINANCIAL YEAR

The Remuneration Committee met 3 times during the 2011 financial year (2 times after its renewal); the average duration exceeded one hour and thirty minutes. All the members in office have always 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.

As detailed in section 4.6, the Committee also met informally after its renewal to carry out a structured and detailed study of the Remuneration Policy in general, and the structure of the remuneration paid to the Chairman, the General Manager and the other Executives with strategic responsibilities, in particular.

Before its renewal, the Committee approved the final balance proposals of the annual variable remuneration paid to the Chairman 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 2010 Financial Statements, as detailed at the end of this Report.

After its renewal the Committee examined and formulated its respective proposals to the Board, after its renewal, concerning the remuneration of the Chairman and the Deputy Chairmen, and assessed those of the Executives with strategic responsibilities and, in particular, the General Manager, the General Counsel and the Institutional Affairs Director, the Administration and Finance Director and the Control Director and also endorsed the criteria adopted for their

⁴⁴ This circumstance characterises 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.

⁴⁵ Self-Regulatory Code: Application criterion 7.C.4.

⁴⁶ Also in accordance with the recommendations of the Self-Regulatory Code: Application Criterion 5.C.1 sub-section d).

⁴⁷ Also in line with the requirements of the Self-Regulatory Code: Application Criterion 5.C.1., sub-section e).

**THE
PRIORITY
OBJECTIVE
IS TO CREATE
SUSTAINABLE
VALUE IN THE
MEDIUM-LONG
TERM**

determination. The Committee also proposed to the Board the procedures to apportion the overall fee assigned by the Shareholders' Meeting.

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.

As already indicated in the Report on Corporate Governance and the Structure of Share Ownership referred to the 2010 financial year, the Committee (prior to its renewal) had approved the final balance proposals of the variable annual remuneration for the Chairman and the Executives with strategic business responsibilities in relation to the results achieved in the 2010 financial year and had approved the General Remuneration Policy, subsequently approved by the Board and submitted to the advisory vote of the Shareholders' Meeting convened to approve the 2010 Financial Statements detailed at the end of this Report.

The Committee met 2 times in the early months of the 2012 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 Company's Remuneration Committee and by the Board of Directors.

In this regard, the reader is referred to the "Remuneration Policy" referred to the 2011 financial year published on the PIRELLI Internet website, and it is important to note that in the light of

the new legislation and the applicable regulatory provisions, the Report on Remuneration updated for the 2012 financial year will be submitted to the Company's Shareholders' Meeting (the Report contains the Remuneration Policy referred to the 2012 financial year and the Statement referred to the 2011 financial year). The Report on Remuneration referred to the 2012 financial year will be made available on the PIRELLI Internet website no later than 21 days prior to the Shareholders' Meeting scheduled for May 10, 2012 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"⁴⁸.

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 five members, who 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, in fact, the 2006 version of the Self-Disciplinary Code recommended this Committee was to be composed 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.

⁴⁸ Also in line with the requirements of the Self-Regulatory Code Principle 8.P.4.

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 made⁴⁹.

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

- ▶ Carlo Secchi (Chairman);
- ▶ Franco Bruni;
- ▶ Paolo Ferro-Luzzi;
- ▶ 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, so that the main risks concerning the Company and its subsidiaries are identified correctly and adequately measured, managed and monitored; (ii) in determining the criteria for the compatibility of these risks to assure a sound and correct business management. 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 man-

agement 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;
- ▶ 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 internal control officer;
- ▶ assesses 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;
- ▶ 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 work plan prepared by the internal control officers, as well as the periodic reports prepared by them;
- ▶ 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.

⁴⁹ The choice made by the Company is stricter than the one provided by the Self-Regulatory Code of Conduct for Listed Companies: criterion of application 8.C.4.

This circumstance characterizes the corporate governance rules adopted by the Company and offers the whole Board of Statutory Auditors the opportunity to directly monitor the activities of the Committees and perform his control functions more effectively.

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 Cor-

porate 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 (hereafter, the "Secretary") acts as the Secretary to the Committee.

The General Counsel and the Internal Audit Director (who attend all the meetings), the Risk Officer, the Responsible Officer, as well as additional representatives of the Company and/or Group attend the 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 Control Officer (who reports to the Committee for Internal Control, Risks and Corporate Governance and to the Board of Statutory Auditors) reports on his activities and attends all the meetings of the Committee for Internal Control, Risks and Corporate Governance.

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 activities⁵⁰.

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 register⁵¹.

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 purpose⁵².

11.4 ACTIVITIES DURING THE FINANCIAL YEAR

The Committee for Internal Control, Risks and Corporate Governance met 10 times during 2011 (8 times after the Committee was reappointed) and all the Committee members attended its meetings, only one member was reported absent at two meetings. The average duration of the meetings was about three hours.

The Committee met twice during the 2012 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. Accordingly, during the 2011 financial year, the Committee endorsed the review (a) of the operating procedures; (b) the processes and (c) the top management reports of the organisation that will accompany the Group to "execute" the Industrial Plan (in this regard, the reader is referred to Section 4.5.2).

The Committee then examined and approved the proposals, subsequently approved by the Board of Directors, concerning the alignment of the Company Bylaws to the regulatory provisions, in particular (i) with Legislative Decree No. 27 dated January 27, 2010 concerning the "Implementation of Directive 2007/36/EC, regarding the exercise of certain rights of shareholders in listed companies" and (ii) with Legislative Decree No. 39 also dated January 27, 2010, concerning the "Implementation of directive 2006/43/EC regarding the statutory auditing of the annual and consolidated accounts, amending directives 78/660/EEC and 83/349/EEC and abrogating directive 84/253/EEC".

The Committee also examined in advance additional proposals to amend the Company Bylaws approved firstly by the Board of Directors and then by the Shareholders' Meeting convened to approve the 2010 Financial State-

50 The choice adopted by the Company is more rigorous compared to the requirement envisaged by the Self-Regulatory Code: Application Criterion 8.C.4. This circumstance characterises the corporate governance rules adopted by the Company and offers the entire Board of Statutory Auditors the opportunity to follow directly the Committee's activities and to perform more effectively the control functions assigned to it.

51 Also in line with the requirements of the Self-Regulatory Code Application Criterion 5.C., sub-section d).

52 Self-Regulatory Code Application Criterion 5.C.1., sub-section e).

ments concerning the implementation of a number of rights envisaged by Legislative Decree No. 27/2010 in order to further promote the participation and exercise of voting rights in the shareholders' meeting.

During the 2011 financial year, the Committee examined the results of the 2010 Board performance evaluation (as already been described in detail in the Company's Governance Report referred to the 2010 financial year) and initiated the self-evaluation process referred to the 2010 financial year, examining the results during 2011. 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 following the periodic risk analysis activity ordered by the Supervisory Body that, on the one hand, resulted in confirming in the "Organisational Model 231" all the internal control schemes relating to the instrumental and operational processes, and on the other hand, the inclusion of internal control schemes relating to the "Market Abuse" operational process and the "Use of Information Technology Tools" operational process, as well as the operational process relating to the "requirements for environmental activities"; for further details in this regard the reader is referred to the section on the Ethical Code, Policies and Organisational Model 231.

The Committee approved the programme of the Committee's activities for the 2012 financial year, also to permit the Independent Directors who do not participate in the Committee to request the Committee to discuss specific issues.

The Committee expressed its assessment on the activities performed by the Internal Control Officer and the Internal Audit Director in order to acknowledge the 2010 variable incentive and expressed an opinion in relation to the 2011 incentive scheme, establishing a significant incidence of the qualitative targets to be assessed by the Committee. During the 2011 financial year the Committee proposed to the Board (and the Board duly approved) a review of the remuneration "mix" referred to the Internal Control Officer reducing the incidence of the variable component in order to obtain an alignment with the best practices relating to the remuneration of the control functions.

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, 2011.

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 2011 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 also examined the report of the activities performed by the Compliance Function and the Plan of activities referred to the 2011 financial year.

The Committee met with the Responsible Officer at the start of the 2011 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, 2010, a similar activity was performed during 2012 in relation to the Financial Statements as of December 31, 2011.

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 2011 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;
- ▶ endorsed in advance the operation to reduce the share capital described in paragraph 2, sub-section a);
- ▶ 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;

- ▶ endorsed the start of a project to implement a structured and integrated model able to identify "automatically" potential shortcomings in the internal control system which may "favour" prejudicial conduct. The project also aims to integrate the traditional cyclic approach, based on limited samples, with continuous and automated audit activities performed in "real time";

Among other activities, the Committee examined in advance the following transactions and the following issues, subsequently submitted to the Board's examination (accordingly, the reader is referred to the section "Activities of the Board of Directors") for further details:

- ▶ endorsed the letter of suggestions submitted by the statutory auditor forwarded to the Company's management;
- ▶ proposed amendments to the Company Bylaws, as mentioned previously;
- ▶ development of events, also legal issues which involved two of the Company's former Security officers;

The Committee expressed a preliminary favourable opinion concerning some transactions of lesser importance executed by the Company or by its subsidiaries in application of the current Principles governing transactions with related parties and prior to the adoption (November 3, 2010) of the Procedure governing transactions with related parties, and also expressed a favourable opinion on the transaction involving the renewal of the loan in favour of Prelios (formerly PIRELLI RE), that was then duly approved by the Board of Directors.

The Committee received a periodic information flow concerning the execution status of the transactions with related parties of lesser importance duly authorised by the Committee.

After consulting the Board of Statutory Auditors the Committee approved a procedure to confer appointments other than the statutory audit on the auditing company appointed to perform the statutory audit of the accounts of PIRELLI & C.

Lastly, the Committee confirmed its positive opinion concerning the adequacy of the internal control system and the governance system of the Company and the Group⁵³ based on the activities performed, the assessments made, the information received and the documentation examined.

The Committee constantly supervised the risk assessment activity during the financial year acknowledging the risk classification in "strategic risks", namely, risks related directly to achieving one or more targets of the Plan, and "transversal risks", namely, risks which, although not related directly to the strategic targets, may however, prejudice achieving the targets by involving transversely several corporate processes/areas and also approved the Group's Annual Risk Assessment and Mitigation Plan, listing the main risks to which the Company is exposed and their respective mitigation plans.

The Committee examined in detail alternative crisis scenarios and their possible impacts on the Company's Industrial Plan and possible mitigation actions.

The Committee approved specific mitigation plans on the basis of this analysis in order to maintain the risk exposure levels within acceptable limits and governance and control guidelines will be defined for their implementation.

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 has been extended to all the Managers of the Business Units, Regions and Departments who report directly to the Chairman or to the Executive Office to assure the policies are shared and to guarantee a more efficient information flow in the framework of the review (a) of the operating procedures; (b) the processes and (c) the top management relations of the organisation that will accompany the Group to "execute" the Industrial Plan described in Section 4.5.2.

⁵³ Refer to the section "Role of the Board of Directors" and the paragraph "Internal control and governance system".

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 MANAGEMENT COMMITTEE HAS BEEN EXTENDED TO ALL THE MANAGERS OF BUSINESS UNITS, REGIONS AND DEPARTMENTS WHO REPORT DIRECTLY TO THE CHAIRMAN OR TO THE EXECUTIVE OFFICE

THE RISK MANAGEMENT COMMITTEE

The Committee is chaired by the General Counsel and has 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 Committee met on a quarterly basis during the 2011 financial year to identify, analyse and define the strategies to respond to the more significant risk events, in particular, to the risks strictly associated with the Group's targets and the strategic choices they reflect (strategic risks) and the risks which may always concern the operational activities (so-called transversal risks).

The Risk Management Committee approved the 2011 Annual Risk Management Plan with reference to the so-called strategic risks, which defined the response strategies and the plans to mitigate the most significant risks already highlighted in the Annual Risk Assessment approved in November 2010 and referring to the 2011 budget period.

The Risk Management Committee monitored periodically during the year the overall exposure of PIRELLI's economic and financial results to the various risk "families" while verifying that the "risk value" was in line with defined risk propensity and tolerances.

The Committee analysed the most significant risk scenarios relating to the 2012-2014 Industrial Plan again with reference to the strategic risks and assessed the "soundness" of the economic and financial targets by submitting them to "stress tests" to verify the Group's economic, financial and equity "capacity" at the occurrence of scenarios which could arise, in particular, due to the external context (economic situation, country risks).

Whereas, as far as the so-called transversal risks are concerned, the Risk Management Committee's activity focused, in particular, on two macro areas: business interruption risks and risks associated with the IT systems.

The Committee analysed the results of the assessment relating to 7 production sites in 2011 with reference to the business interruption risks (5 sites had already been assessed during 2010).

The analyses performed confirmed an adequate supervision of the business interruption risks, thanks to a structured series of safety measures and prevention systems. In any event the preparation and implementation of specific "business continuity" plans were foreseen for all the production facilities analysed and which will also need to concern the supply chain.

The Risk Committee constantly monitored the implementation of the actions to enhance the safety supervision arrangements (physical, logical and infrastructural) with reference to the risks associated with Information Technology defined during 2010.

Lastly, the Committee also extended the risk assessment to the new strategic initiatives, in

particular, to the investment projects designed to increase the production capacity.

THE SUSTAINABILITY STEERING COMMITTEE

The Sustainability Steering Committee is chaired by the Chairman of the Board of Directors and has the following tasks: (i) to prepare the Group's sustainability plans based on the international policies and principles applicable to this area; (ii) to monitor the operative deployment of the plans; (iii) to prepare the Sustainability Report; (iv) to prepare the Company's plans for Equal Opportunities.

The Sustainability Steering Committee includes all the functions of the value chain represented by the respective 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. The Departments mentioned represent the various interests of the reference stakeholders; converging the different interests within the Steering Committee, making the Committee become the key body to define the most balanced strategy in terms of a shared development and a multi-stakeholder approach.

The Steering Committee updated the three-year sustainability plan during 2011, aligning the plan with the developing international scenario and with the respective new expectations, to achieve full integration with the updated version of the Group's Development Plan. The 2012-14 Sustainability Plan integrates, accompanies and supports the achievement the Industrial Plan's strategic targets.

All the objectives of the environmental, social and economic sustainability plan already initiated in 2011 and disclosed to the market in November of the same year, were rendered more challenging when updating the 2012-2014 Plan with an outlook extending to 2015.

The Plan's principal targets are represented by process and product innovation designed to achieve the safety of persons and to protect the environment, extending PIRELLI's sustainable corporate management Model to the new industrial facilities which will become part of the Group, the commitment to transform the final customer's education referred to road safety into an effective "safety culture", to enhance the Company's staff, in addition to a significant investment in training.

The Company's sustainable management and development Model will be the central feature of the integration of the new production facilities in Mexico, Russia and Indonesia.

The co-operation with governmental and non-governmental authorities will be strengthened in the framework of the relations with local and international communities to share initiatives designed to develop the sustainability culture, in particular, referred to road safety.

Lastly, the Committee analysed the results of the 2011 assessments performed by analysts concerning the main socially responsible investment indexes. In particular, PIRELLI's rating prepared by the EIRIS analysts referred to the FTSE4 Good indexes corresponded to 88/100, while the SAM Group 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 fifth consecutive year, with a rating corresponding to 91/100 compared to a sector average that corresponds to 53.

The Sustainability Report (Volume C of the document "Financial Report as of 31/12/2011") provides a complete description of PIRELLI's sustainable performance in 2011.

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 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;

Fig. 3

Teamwork



- ▶ 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.

**PIRELLI. FOR THE FIFTH
CONSECUTIVE YEAR,
WAS AWARDED WITH
THE WORLD
SUSTAINABILITY
LEADERSHIP AWARD
IN THE
"AUTOPARTS AND TYRE"
SECTOR OF THE
DOW JONES
SUSTAINABILITY STOXX
AND THE
DOW JONES
SUSTAINABILITY
WORLD: RATING 91/100
(AVERAGE SECTOR 53)**

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 Executive Office 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 meets once a month to verify the consistency of the Group's organisational structure with the growth targets and the business challenges and in order to monitor the quality of the managerial resources and their performance and to define development programmes to support the business initiatives.

The Committee is chaired by the Chairman and Managing Director and is composed of: the Chief Operating Officer; 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 PLANS⁵⁴

The Appointments and Succession Committee has met twice from the date it was set up and 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 the Company (i) to monitor the key resources within the Company 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.

In the early months of 2012 the Appointments and Succession Committee appointed

⁵⁴ The information included in this section is also provided in compliance with the Consob recommendation contained in Communication DEM/11012984 dated February 24, 2011.

a specialised company to support PIRELLI in the Governance of the succession plans for top and senior management; the company appointed forms part of a global network.

In particular, during 2012, with the support of the appointed consultancy firm, PIRELLI intends to identify the key functions/areas to develop the business further and to verify the potential for internal growth and then, in a subsequent phase, to monitor the market of Senior Executives with special talents, on an international level, in order to identify profiles of potential interest for the Group.

It is important to remember that the Organisation and People Review Management Committee was also set up during 2011.

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) the separation of roles when performing the principal activities involved in individual operating processes; (ii) the traceability and constant visibility 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 an Officer with an appropriate level of independence and suitable means to perform the function, 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 Code⁵⁵ 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 design, implementation and management of the internal control system and verifying constantly the overall adequacy, effectiveness and efficiency;

⁵⁵ Also to implement the recommendations of the Self-Regulatory Code Application criterion 8.C.1., sub-section b).

- ▶ 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 one or more internal control officers.

14.2 INTERNAL CONTROL OFFICER

The Board of Directors, following its renewal, with the favourable opinion of the Committee for Internal Control, Risks and Corporate Governance and in line with best practices, based on the proposal made by the Director responsible for the internal control system, has confirmed that the Internal Control Officer is the head of the Internal Audit Department (Mr. Maurizio Bonzi), and the Internal Control Officer reports to the Committee for Internal Control, Risks and Corporate Governance and to the Board of Statutory Auditors (to which the Officer reports functionally).

The Internal Control Officer is responsible for verifying that the internal control system is always adequate and fully operational.

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

Furthermore, the Directors with strategic business responsibilities and Directors responsible for specific services and functions sit on the Boards of Directors of the principal subsidiary companies in order to pursue the strategies and policies adopted by the Parent Company.

Moreover, the Group Compliance Function has been fully implemented and reports to the Director of Legal and Corporate Affairs and Group Compliance, which is therefore separate from the Internal Audit Department, called on to collaborate with the other group departments to assure the constant alignment of the internal standards, processes, and more in general, the Company's business activities with the applicable regulatory framework.

In line with best practices the Group Compliance function is responsible for monitoring the risk of not complying with the laws, regulations and in general, with legislation, also self-regulatory, in order to avoid legal and administrative sanctions, or significant financial losses or damage to reputation.

The internal control system is rendered even more effective by the procedure to notify breaches, suspected breaches and induction to breach laws and regulations; the principles sanctioned in the Ethical Code; the internal control principles; company standards and procedures and/or any other action or omission that may directly or indirectly give rise to an economic-

equity loss, or also reputational damage for the Group and/or its companies.

The Procedure envisages an express protection concerning any kind of reprisal against persons that identify such breaches or employees who collaborated to investigate the validity of the notification.

INTERNAL AUDIT DEPARTMENT

The Internal Audit Department (managed by Maurizio Bonzi as has been mentioned) 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 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 16 persons of five different nationalities with an average of 6 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 2012 financial year envisages audits in 22 countries in all the various continents, involving more than 20 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 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 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 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.

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.

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 periodic 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 Board of Directors is supported by the Risk Management Committee (chaired by the General Counsel and composed of the Chief Operating Officer; Finance Manager; Group Control Manager; Internal Audit Manager; Legal and Corporate Affairs and Group Compliance Manager; Investor Relations Manager and the Senior Advisor Human Resources).

THE BOARD EVALUATES THE ACCEPTABLE RISK THRESHOLD (RISK APPETITE)

The Risk Management Committee has 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 Managerial Committee avails itself 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 individual 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:

- ▶ (i) definition of the risk model;
- ▶ (ii) risk analysis;
- ▶ (iii) risk management.

PIRELLI's Risk Model is a model that is used to represent the risk portfolio to which the Group is exposed, and is based on two key areas:

- ▶ **Strategic Risks, which are closely linked to PIRELLI's objectives and to the strategic choices. This category includes the risks associated with the developments of the “external scenario” in which PIRELLI operates and some risks stemming from internal factors (financial risks, risks associated with typical business processes and risks associated with human resources and the organisation).**
- ▶ **Transversal Risks, which can always impact the operational activities, regardless of the strategies currently implemented. This area includes the business interruption risks, risks associated with the IT systems, risks linked with compliance with laws and regulations and the risks linked with the financial reporting process.**

The Managerial Committee identifies the priority risk areas in relation to the industrial plan's objectives and the strategic lines (key value driver) with reference to the Risk Model (for example: raw materials/commodities, economic situation, competitors, exchange rates), these areas are examined in greater detail in the subsequent Risk Analysis phase. The significant production sites for the Group's growth strategies and the information systems to support the core processes are also identified in relation to the Business Continuity and Information Technology transversal risks.

The Risk Management 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 and financial/tax charges);
- ▶ 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 priority risk areas are analysed and discussed with the Senior Management in order to identify specific risk scenarios/events for which the region/country and business function Managers are required to assess the exposures.

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 Risk Management 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 three-year 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.

PIRELLI's Risk Model was evaluated as the best-in-class in 2011 in the "Autoparts and Tyres" sector by the SAM Group in an assessment for the Dow Jones Indexes in 2011.

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 Organizations of Tradeway 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 (F. 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 Statements 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, selected 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 ETHICAL CODE – CODE OF CONDUCT AND ORGANISATIONAL MODEL 231

The internal control system described above is completed by:

- ▶ the Group's Ethical Code;
- ▶ the Group's Code of Conduct;
- ▶ Organisational Model 231

The Ethical Code sets out the general principles which form the reference framework to perform and conduct business within PIRELLI; the Ethical Code 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 Ethical Code 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 Code of Conduct contain the "operative" statement of the principles contained in the Ethical Code and establish rules for the entire Group designed to prevent the creation of an environment that is favourable to committing offences in general.

The Ethical Code and the Code of Conduct 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 Ethical Code, 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 Code of Conduct, 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 Paolo Domenico Sfameni and the Internal Audit Manager and Internal Control Officer, 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 companies registered in the special register kept by Consob.

Reconta Ernst & Young S.p.A.⁵⁶ 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, 2011.

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 companies in the Ernst&Young network establishing the required prior and express authorisation by the Finance Director who is responsible, with the support of the Internal Audit Director, 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.

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 Bylaws⁵⁷ 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 established for Directors.

In the meeting held on April 21, 2011 the Board of Directors confirmed the Chief Financial Officer Francesco Tanzi 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:

⁵⁶ Refer to the Minutes of the Shareholders' Meeting held on April 29, 2008 available on the Company's Internet website.

⁵⁷ Article 11 of the Company Bylaws.

- ▶ a) to prepare adequate administrative and accounting procedures to draw up the annual and consolidated Financial Statements, as well as every other financial communication;
- ▶ b) 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;
- ▶ c) 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 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 Bylaws 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, without 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.

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 white-wash 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 information⁵⁸.

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

- ▶ a) the financial reporting process;
- ▶ b) the efficiency of the internal control system, the internal audit, and risk management;
- ▶ c) the statutory audit of the annual accounts and the consolidated accounts;
- ▶ d) 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, the Statutory Auditor, Paolo Domenico Sfameni was invited to become a member of the Supervisory Body, in accordance with Legislative Decree No. 231/2001.

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. In order to permit the minority shareholders to elect one Statutory Auditor and one Alter-

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

In accordance with the Company Bylaws shareholders, who alone, or together with other shareholders own an overall number of shares which represent at least 1.5% of the shares with voting rights in the Ordinary Shareholders' Meeting or the smaller percentage established by Consob⁵⁹ are entitled to present a list.

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 point⁶⁰, 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;

⁵⁹ Consob established the percentage shareholding referred to the 2011 financial year required for shareholders to present the lists of candidates to be elected to the administration and control bodies of Pirelli & C. that corresponds to 1.5 percent of the share capital with voting rights in the Ordinary Shareholders' Meeting in its Resolution No. 18083 dated January 25, 2011.

⁶⁰ 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".

⁵⁸ Now referred to as "privileged information" (Article 114 of the Unified Finance Law (TUF)).

- ▶ 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 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 differ-

ing 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.

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 April 21, 2009 resolved to renew the Board of Statutory Auditors for the 2009 - 2011 financial years, by appointing Enrico Laghi, Paolo Gualtieri and Paolo Domenico Sfameni as Statutory Auditors and by appointing Luigi Guerra and Franco Ghiringhelli as Alternate Auditors, accordingly, they shall fall from office in the Shareholders' Meeting convened to approve the 2011 Financial Statements, after completing their mandate.

The appointment was based on the voting list system. The only list was presented by the members of the PIRELLI & C. Shareholders' Agreement ("Sindacato di Blocco Azioni PIRELLI & C.") that obtained about 95% of the favourable votes of the share capital with voting rights represented in the Shareholders' Meeting. Enrico Laghi was appointed as Chairman of the Board of Statutory Auditors in the absence of members of the Board of Statutory Auditors originating from the minority list.

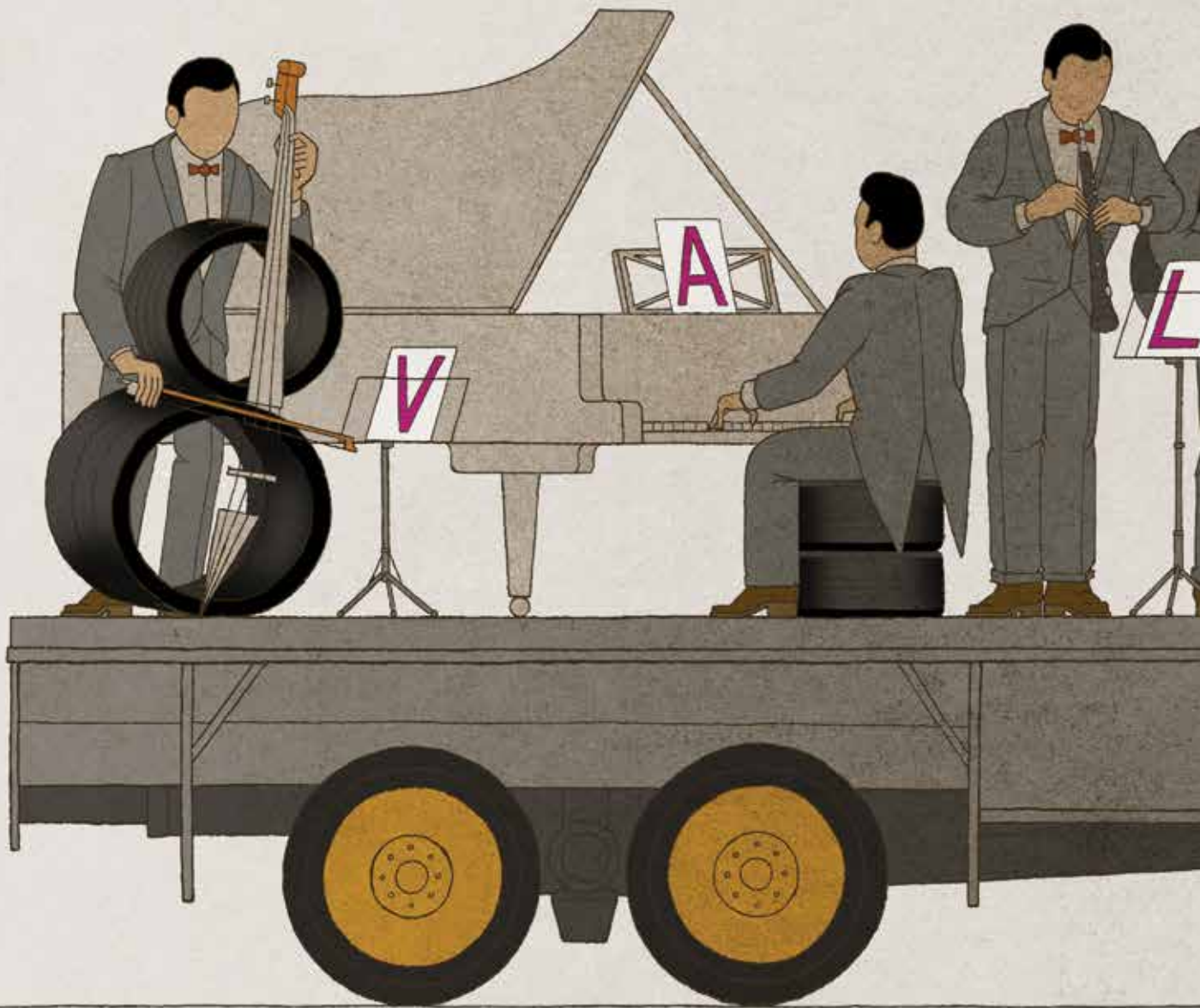
The Shareholders' Meeting also established the annual gross fee to be paid to each Statutory Auditor at euro 41,500 and the annual gross fee to be paid to the Chairman of the Board of Statutory Auditors at euro 62,000.

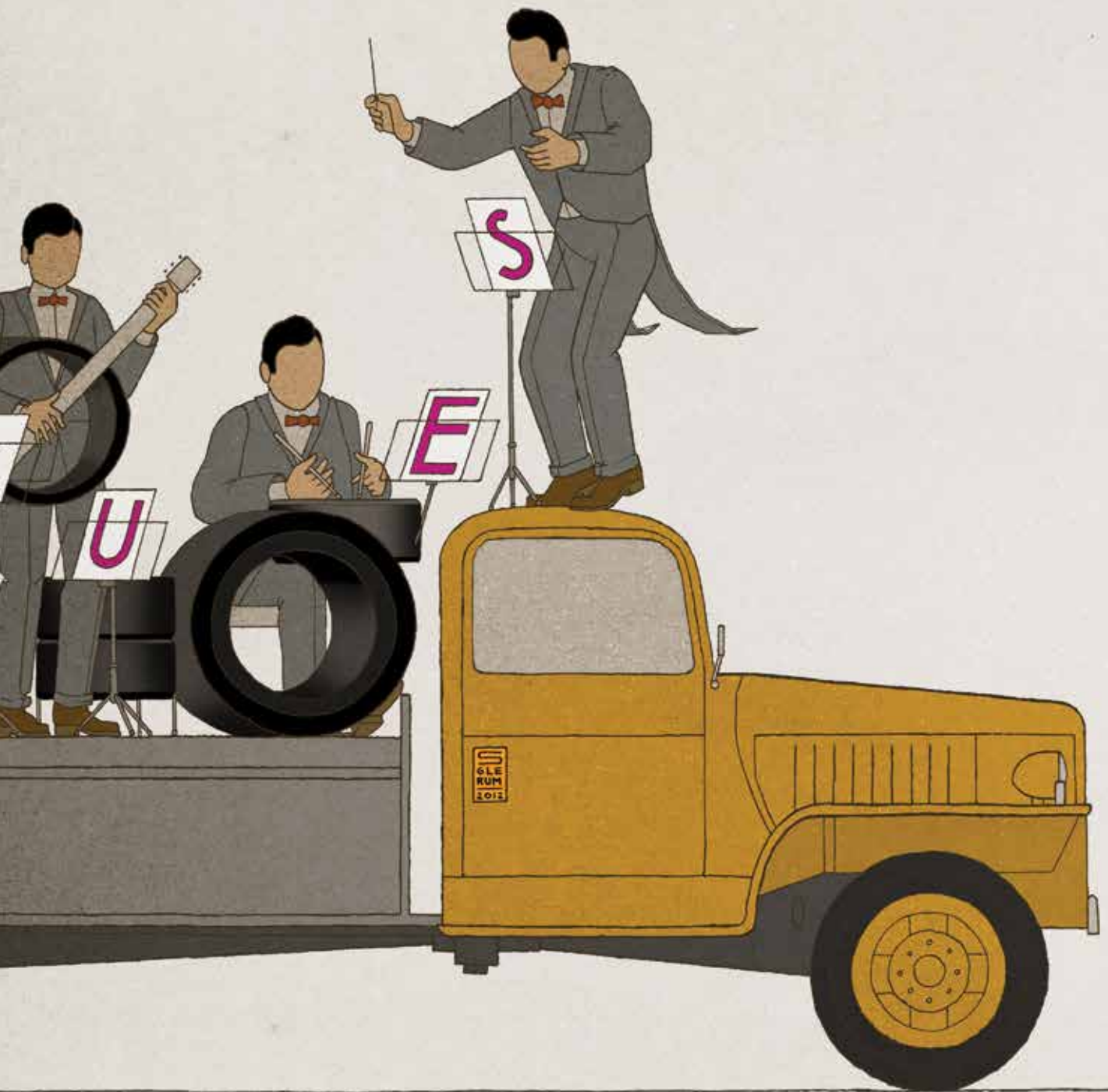
Furthermore, the Statutory Auditor invited to take part in the Supervisory Body, pursuant to Legislative Decree No. 231/2001 (Paolo Domenico Sfameni) effective from April 21, 2011 is to be paid an additional annual gross fee of euro 25,000.

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

Fig. 4

Values





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 Code⁶¹ 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, 2008⁶².

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 Code⁶³.

ACTIVITIES OF THE BOARD OF STATUTORY AUDITORS

The Board of Statutory Auditors held 8 meetings during the financial year and the percentage attendance of the Auditors was higher than 90% (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 convened to examine the review (a) of the operating procedures; (b) the processes and (c) the top management relations of the organisation that will accompany the Group to "execute" the Industrial Plan (described in section 4.5.2).

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 information⁶⁴.

The Board of Statutory Auditors reported on the activities performed to the Shareholders' Meeting held in April 2011 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 monitored⁶⁵ 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 Auditors⁶⁶ coordinated its activities with the Internal Audit Department and as has been stated, the respective

⁶¹ Self-Regulatory Code Application Criterion 10.C.2.

⁶² 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)".

⁶³ Self-Regulatory Code Application Criterion 10.C.4.

⁶⁴ Now referred to as "privileged information" (Article 114 of the Unified Finance Law (TUF)).

⁶⁵ Also in line with the Self-Regulatory Code: Application Criterion 10.C.5.

⁶⁶ Self-Regulatory Code: Application Criteria 10.C.6. and 10.C.7.

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 Article 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, today, already 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 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, as well as endorsing the letter of suggestions prepared by the statutory auditor and forwarded to the Company's management.

**THE PIRELLI
INTERNET
WEBSITE
DEDICATES
A SECTION
CALLED
INVESTOR
DESIGNED
TO ESTABLISH
AN OPEN,
IMMEDIATE AND
TRANSPARENT
DIALOGUE WITH
ALL PARTIES
REQUIRING
FINANCIAL
INFORMATION**

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 investors in the case of 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.

The Investor Relations has an e-mail address (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" during 2011 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 discipline that governs the operation of the Shareholders' Meetings has been profoundly innovated following the provisions introduced to 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 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, within five days from the date of publication of the Notice to convene the Shareholders' Meeting, indicating in the application the additional topics which they propose.

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 may be held in first or second call (in third call only in the case of extraordinary Shareholders' Meeting) or in a single call, in this case 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, the Shareholders' Meeting is to be constituted and resolves based on the following procedures, with the exception of specific matters for which the laws and regulations envisage a different majority:

- ▶ in the ordinary session:
 - the Shareholders' Meeting in first call shall be deemed validly constituted subject to the presence of shareholders representing at least half of the share capital and resolves with the absolute majority of the share capital represented;
 - the Shareholders' Meeting in second call (or only call) 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 in first call shall be deemed validly constituted subject to the presence of shareholders representing at least one half of the share capital and resolves with the favourable vote of at least two thirds of the share capital represented;
 - the Shareholders' Meeting in second call shall be deemed validly constituted with the presence of shareholders representing more than one third of the share capital and resolves with the favourable vote of at least two thirds of the share capital represented;
 - the Shareholders' Meeting in third call (or only call) 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, 2007⁶⁷.

The Shareholders' Meeting is chaired, in order of priority, by the Chairman of the Board of

Directors, by a Deputy 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 influence 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:

⁶⁷ The Regulations for Shareholders' Meetings are detailed at the end of the Report and are available on the Internet website.

a) use of the relevant section on PIRELLI's Internet website, indicated by the Company in the Notice of Call;

b) 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.

2011 SHAREHOLDERS' MEETINGS

Two Shareholders' Meetings were held during the 2011 financial year, once on April 21, 2011, in second call with the participation of about 63% of the ordinary share capital to discuss (i) approval of the Financial Statements as of 31

December 2010 (approved by the favourable votes of 99.698% of the share capital represented at the meeting); (ii) to appoint the Board of Directors (in this regard, the reader is referred to the whole of section 4 "Board of Directors"); (iii) a Consultation on the Group's General Remuneration Policy (approved by the favourable votes of 89.647% of the share capital represented at the meeting).

In the extraordinary session the Shareholders' Meeting approved the amendment to Article 5 (Share Capital), to Articles 7 and 8 (Shareholders' Meeting), to Articles 10 and 11 (Administration) of the Company Bylaws (duly approved by the favourable votes of 99.171% of the share capital represented in the meeting), as well as the voluntary reduction of the share capital described in paragraph 2, subsection a) "Share Capital structure" (by the favourable votes of 99.229% of the share capital represented at 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 Bylaws⁶⁸ 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 on January 31, 2012 appointed prof. Giuseppe Niccolini as the Common Representative for the savings shareholders for the 2012-2014 financial years (with the favour-

⁶⁸ Article 6 of the Company Bylaws.

able 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.

Tables

Annex

TABLES

TABLE NO. 1

SHARE CAPITAL STRUCTURE

The exact breakdown of the share capital is illustrated below.

	NO. OF SHARES	% IN RELATION TO SHARE CAPITAL	LISTED
Ordinary shares*	475.740.182	97,49%	Listed on the Italian Electronic Stock Exchange ("Mercato Telematico Azionario") organised and managed by Borsa Italiana S.p.A. – Blue Chip Segment.
Savings shares**	12.251.311	2,51%	Listed on the Italian Electronic Stock Exchange ("Mercato Telematico Azionario") organised and managed by Borsa Italiana S.p.A. – Blue Chip Segment.

* ISIN Code IT0000072725

** ISIN Code IT0000072733

TABLE NO. 2

SIGNIFICANT SHAREHOLDINGS IN THE CAPITAL

The Table illustrates the Parties which own shares with voting rights in the ordinary Shareholders' Meeting and exceeding 2% of the ordinary share capital, according to the information published by Consob at the date this Report was published.

Declarant or party ranking top of the shareholding chain	Direct Shareholder		% Stake on Voting Capital				% Stake on Ordinary Capital			
			% Stake	of which Without Vote			% Stake	of which Without Vote		
	Name	Title of ownership		% Stake	Voting rights referred to			% Stake	Voting rights referred to	
					Party	% Stake			Party	% Stake
ASSICURAZIONI GENERALI SPA	GENERTELLIFE SPA	Ownership	0.001	0.000		0.001	0.000			
		Total	0.001	0.000		4.773	0.000			
	ALLEANZA TORO SPA	Ownership	0.189	0.000		0.025	0.000			
		Total	0.189	0.000		0.025	0.000			
	GENERALI VIE SA	Ownership	1.097	0.000		0.003	0.000			
		Total	1.097	0.000		0.003	0.000			
	INA ASSITALIA SPA	Ownership	2.005	0.000		2.005	0.000			
		Total	2.005	0.000		2.005	0.000			
	ASSICURAZIONI GENERALI SPA	Ownership	2.177	0.000		2.177	0.000			
		Total	2.177	0.000		2.177	0.000			
Total			5.469	0.000		5.469	0.000			
EDIZIONE SRL	EDIZIONE SRL	Ownership	4.773	0.000		4.773	0.000			
		Total	4.773	0.000		4.773	0.000			
	Total			4.773	0.000		4.773	0.000		
PREMAFIN FINANZIARIA SPA HOLDING DI PARTECIPAZIONI	POPOLARE VITA SPA	Ownership	0.003	0.000		0.001	0.000			
		Total	0.003	0.000		0.001	0.000			
	MILANO ASSICURAZIONI SPA	Ownership	0.025	0.000		0.001	0.000			
		Total	0.025	0.000		0.001	0.000			
	FONDIARIA - SAI SPA	Ownership	4.454	0.000		0.001	0.000			
		Total	4.454	0.000		4.518	0.000			
Total			4.482	0.000		4.482	0.000			
ALLIANZ SE	ANTONIANA VENETA POPOLARE VITA SPA	Ownership	0.001	0.000		0.023	0.000			
		Total	0.001	0.000		0.023	0.000			
	CREDITRAS VITA SPA	Ownership	0.001	0.000		25.542	0.000			
		Total	0.001	0.000		25.542	0.000			
	ALLIANZ SPA	Ownership	0.001	0.000		4.518	0.000			
		Total	4.520	0.000		4.518	0.000			
Total			4.520	0.000		4.520	0.000			
TRONCHETTI PROVERA MARCO	CAM PARTECIPAZIONI SPA	Ownership	0.023	0.000		0.023	0.000			
		Total	0.023	0.000		0.023	0.000			
	CAMFIN SPA	Ownership	25.542	0.000		25.542	0.000			
		Total	25.542	0.000		25.542	0.000			
Total			25.565	0.000		25.565	0.000			
MEDIOPANCA SPA	MEDIOPANCA SPA	Ownership	3.954	0.000		3.954	0.000			
		Total	3.954	0.000		3.954	0.000			
	Total			3.954	0.000		3.954	0.000		

Nota:

The information relating to shareholders that directly or indirectly own ordinary shares corresponding to more than 2% of the share capital with voting rights at the ordinary Shareholders' Meetings of the Companies is taken from the Consob Internet website. In this regard, it is deemed helpful to indicate that the information published by Consob on its website, based on the communications made by the parties bound by the obligations set out under Article 120 of the Unified Finance Law (TUF) and the Issuers' Regulations, could differ significantly from the real situation, since the obligations to report changes in the percentage shareholding held do not arise with the simple variation of this percentage but only when "exceeding" or "falling below" given thresholds (2%, 5%, and subsequent multiples of 5% up to the 50% threshold and, beyond this threshold 66.6%, 75%, 90% and 95%). It follows, for example, that a shareholder (i.e. declarant party) that has declared that it owns 2.6% of the share capital with voting rights may increase its shareholding up to 4.9% without the party concerned being under an obligation to notify Consob, pursuant to Article 120 of the Unified Finance Law (TUF).

TABLE NO. 3

COMPOSITION OF THE BOARD OF DIRECTORS

The composition of the Board of Directors at the Date of the Report is illustrated below.

NAME	OFFICE	IN OFFICE FROM	LIST	EXEC.	NON-EXEC.	INDEP.	INDEP. UFL	% BOD	DATE OF FIRST APPOINTMENT IN PIRELLI & C. S.P.A.
Marco Tronchetti Provera	Chairman	21/04/2011	Major.	X				100%	07/05/2003
Vittorio Malacalza	Deputy Chairman	21/04/2011	Major.		X			83%	29/07/2010
Alberto Pirelli	Deputy Chairman	21/04/2011	Major.	X				100%	07/05/2003
Carlo Acutis	Board Member	21/04/2011	Major.		X	X	X	83%	07/05/2003
Anna Maria Artoni	Board Member	21/04/2011	Major.		X	X	X	83%	21/04/2011
Gilberto Benetton	Board Member	21/04/2011	Major.		X			67%	07/05/2003
Alberto Bombassei	Board Member	21/04/2011	Major.		X	X	X	67%	12/09/2006
Franco Bruni	Board Member	21/04/2011	Minor.		X	X	X	100%	28/04/2005
Luigi Campiglio	Board Member	21/04/2011	Major.		X	X	X	100%	29/04/2008
Paolo Ferro-Luzzi	Board Member	21/04/2011	Major.		X	X	X	100%	21/04/2011
Pietro Guindani	Board Member	21/04/2011	Minor.		X	X	X	100%	21/04/2011
Giulia Maria Ligresti	Board Member	21/04/2011	Major.		X			83%	07/05/2003
Elisabetta Magistretti	Board Member	21/04/2011	Minor.		X	X	X	100%	21/04/2011
Massimo Moratti	Board Member	21/04/2011	Major.		X			50%	07/05/2003
Renato Pagliaro	Board Member	21/04/2011	Major.		X			100%	29/04/2008
Giovanni Perissinotto	Board Member	21/04/2011	Major.		X			50%	07/05/2003
Luigi Roth	Board Member	21/04/2011	Major.		X	X	X	100%	23/04/2007
Carlo Secchi	Board Member	21/04/2011	Major.		X	X	X	100%	19/02/2004
Manuela Soffientini*	Board Member	01/04/2011	-		X	X	X	-*	01/03/2012
Giuseppe Vita*	Board Member	01/04/2011	-		X			-*	01/03/2012

Legend

List: Major./Minor. depending on whether the Director was elected from the list voted by the majority, or by a majority

Exec.: if crossed, this indicates that the Board Member can be qualified as executive

Non exec.: if crossed, this indicates that the Board Member can be qualified as non-executive

Indep.: if crossed, this indicates that the Board Member can be qualified as independent, in accordance with the criteria established by the Self-Regulatory Code.

Indep. UFL: if crossed, this indicates that the Director satisfies the independence requirements established under Article 148, paragraph 3 of the Unified Finance Law (UFL).

% BoD: this indicates the presence, in percentage terms, of the Board Member at the Board of Directors' meetings. The percentage is calculated on the basis of the Board Member's presence at the meetings after the Board was renewed by the Shareholders' Meeting in the session held on April 21, 2011. The percentage presence referred to the Board Members indicated in the table and also in office in the prior mandate is illustrated below and takes into account all the Board of Directors' meetings during the 2011 financial year: Marco Tronchetti Provera (100%); Vittorio Malacalza (86%); Alberto Pirelli (100%); Carlo Acutis (86%); Gilberto Benetton (71%); Alberto Bombassei (71%); Franco Bruni (100%); Luigi Campiglio (100%); Giulia Maria Ligresti (86%); Massimo Moratti (57%); Renato Pagliaro (100%); Giovanni Perissinotto (43%); Luigi Roth (100%); Carlo Secchi (100%).

*The Board Member was appointed as a Company Director on March 1, 2012, pursuant to Article 2386 of the Italian Civil Code.

The Directors that discontinued holding office during the financial year are illustrated below:

NAME	OFFICE	IN OFFICE IN THE COMMITTEE FROM	LIST	EXEC.	NON-EXEC.	INDEP.	INDEP. UFL	% BOD
Carlo Angelici*	Board Member	Dal 29/04/2008 al 21/04/2011	Minor.		X	X	X	100%
Cristiano Antonelli*	Board Member	Dal 29/04/2008 al 21/04/2011	Minor.		X	X	X	100%
Enrico Tommaso Cucchiani**	Board Member	Dal 21/04/2011 al 16/12/2011	Major.		X			17%
Umberto Paolucci*	Board Member	Dal 29/04/2008 al 21/04/2011	Minor.		X	X	X	100%
Giampiero Pesenti*	Board Member	Dal 29/04/2008 al 21/04/2011	Major.		X	X	X	100%
Francesco Profumo***	Board Member	Dal 21/04/2011 al 16/11/2011	Minor.		X	X	X	100%

Legend

The reader is referred to the legend of the two preceding tables.

The calculation of the percentage attendance at the Board of Directors' meetings takes into account the meetings which the Director attended before discontinuing holding office compared to the number of meetings held during the financial year until the date the Director discontinued holding office.

* Board Members that discontinued holding office after completing their mandate with the Shareholders' Meeting convened to approve the Financial Statements as of 31 December 2001.

** The Board Member, Mr. Cucchiani resigned from office on 16/12/2011 due to other positions accepted in other companies. Accordingly, the Board Member, Mr. Cucchiani also held office in the previous mandate (which expired with the approval of annual Financial Statements closed as of 31 December 2011 by the Shareholders' Meeting held on April 21, 2011). The percentage attendance of the Board Member, Mr. Cucchiani corresponded to 29%, by taking into account all the Board of Directors meetings held in the 2011 financial year (therefore, also before the Board of Directors was renewed).

***The Board Member, Mr. Profumo resigned from office following his appointment as a Minister of the Italian Republic.

TABLE NO. 4

COMPOSITION OF THE ADVISORY COMMITTEES

The composition of the Advisory Committees established within the Board of Directors at the Date of the Report is illustrated below:

Committee for Internal Control, Risks and Corporate Governance

NAME	OFFICE	IN OFFICE IN THE COMMITTEE FROM	LIST	EXEC.	NON-EXEC.	INDEP.	% COMMITTEE
Carlo Secchi	Chairman	21/04/2011	Magg.		X	X	100%
Franco Bruni	Member	21/04/2011	Min.		X	X	88%
Paolo Ferro-Luzzi	Member	21/04/2011	Magg.		X	X	100%
Elisabetta Magistretti	Member	21/04/2011	Min.		X	X	100%
Luigi Roth	Member	21/04/2011	Magg.		X	X	88%

Legend

List: Major./Minor. depending on whether the auditor was elected from the list voted by the majority, or by a minority (Article 144-decies of the Issuers' Regulations).

Exec.: if crossed, this indicates that the Board Member can be qualified as executive

Non-exec.: if crossed, this indicates that the Board Member can be qualified as non-executive

Indep.: if crossed, this means that the auditor can be qualified as independent, in accordance with the criteria established by the Self-Regulatory Code, clarifying at the bottom of the table whether these criteria were supplemented or changed.

% Committee: indicates the presence, in percentage terms, of the Board Member at the committee meetings to which the table refers. The percentage is calculated on the basis of the Board Member's presence at the meetings after the Board was renewed by the Shareholders' Meeting in the session held on April 21, 2011. The percentage presence referred to the Board Members indicated in the table and forming part of the Committee to which the table refers also in the previous mandate is illustrated below, and therefore, takes into account all the meetings of the cited Committee held during the 2011 financial year: Franco Bruni (90%); Luigi Roth (90%); Carlo Secchi (100%).

Remuneration Committee

NAME	OFFICE	IN OFFICE IN THE COMMITTEE FROM	LIST	EXEC.	NON ESEC.	INDEP.	% COMMITTEE
Carlo Acutis	Chairman	21/04/2011	Magg.		X	X	100%
Anna Maria Artoni	Member	21/04/2011	Magg.		X	X	100%
Pietro Guindani	Member	21/04/2011	Min.		X	X	100%
Luigi Roth	Member	21/04/2011	Magg.		X	X	100%

Legend

List: Major./Minor. depending on whether the auditor was elected from the list voted by the majority, or by a minority (Article 144-decies of the Issuers' Regulations).

Exec.: if crossed, this indicates that the Board Member can be qualified as executive

Non-exec.: if crossed, this indicates that the Board Member can be qualified as non-executive

Indep.: if crossed, this means that the auditor can be qualified as independent, in accordance with the criteria established by the Self-Regulatory Code, clarifying at the bottom of the table whether these criteria were supplemented or changed.

% Committee: indicates the presence, in percentage terms, of the Board Member at the respective committee. The Remuneration Committee was completely renewed on April 21, 2011, following the renewal of the Board of Directors.

Strategies Committee

NAME	OFFICE	IN OFFICE IN THE COMMITTEE FROM	LIST	EXEC.	NON-EXEC.	INDEP.	% COMMITTEE
Marco Tronchetti Provera	Chairman	21/04/2011	Major.	X			100%
Vittorio Malacalza	Member	21/04/2011	Major.		X		100%
Franco Bruni	Member	21/04/2011	Minor.		X	X	100%
Renato Pagliaro	Member	21/04/2011	Major.		X		100%
Carlo Secchi	Member	21/04/2011	Major.		X	X	100%
Francesco Chiappetta	Member	21/04/2011	Pirelli Director				100%
Francesco Gori	Member	21/04/2011	Pirelli Director				100%

Legend

List: Major./Minor. depending on whether the auditor was elected from the list voted by the majority, or by a minority (Article 144-decies of the Issuers' Regulations).

Exec.: if crossed, this indicates that the Board Member can be qualified as executive

Non-exec.: if crossed, this indicates that the Board Member can be qualified as non-executive

Indep.: if crossed, this means that the auditor can be qualified as independent, in accordance with the criteria established by the Self-Regulatory Code, clarifying at the bottom of the table whether these criteria were supplemented or changed.

% Committee: indicates the presence, in percentage terms, of the Board Member at the respective committee. The Committee to which the table refers was established by the Board of Directors for the first time on April 21, 2011.

Appointments and Succession Committee

NAME	OFFICE	IN OFFICE IN THE COMMITTEE FROM	LIST	EXEC.	NON-EXEC.	INDEP.	% COMMITTEE
Marco Tronchetti Provera	Chairman	21/04/2011	Major.	X			100%
Vittorio Malacalza	Member	21/04/2011	Major.		X		100%
Luigi Campiglio	Member	21/04/2011	Major.			X	100%
Luigi Roth	Member	21/04/2011	Major.			X	100%

Legenda

List: Major./Minor. depending on whether the auditor was elected from the list voted by the majority, or by a minority (Article 144-decies of the Issuers' Regulations).

Exec.: if crossed, this indicates that the Board Member can be qualified as executive

Non-exec.: if crossed, this indicates that the Board Member can be qualified as non-executive

Indep.: if crossed, this means that the auditor can be qualified as independent, in accordance with the criteria established by the Self-Regulatory Code, clarifying at the bottom of the table whether these criteria were supplemented or changed.

% Committee: indicates the presence, in percentage terms, of the Board Member at the respective committee. The Committee to which the table refers was established by the Board of Directors for the first time on April 21, 2011.

The Committee Members that discontinued holding office during the financial year are illustrated below:

NAME	OFFICE	IN OFFICE FROM/ TO	C.R.	CCIRCG	STR. C.	% COMMITTEE
Carlo Angelici	Member	From 29/04/2008 to 21/04/2011		X		100%
Cristiano Antonelli	Member	From 29/04/2008 to 21/04/2011	.	X		100%
Alberto Bombassei	Member	From 29/04/2008 to 21/04/2011	X			100%
Umberto Paolucci	Member	From 29/04/2008 to 21/04/2011	X			100%
Giampiero Pesenti	Member	From 29/04/2008 to 21/04/2011	X			100%
Francesco Profumo	Member	From 21/04/2011 to 16/11/2011			X	67%

Legenda

The reader is referred to the legend of the two preceding tables.

* The calculation of the percentage attendance in the meetings has taken into account the meetings which the Director attended before discontinuing holding office compared to the number of meetings held during the financial year until the date the Director discontinued holding office.

TABLE NO. 5

COMPOSITION OF THE BOARD OF STATUTORY AUDITORS

The composition of the Board of Statutory Auditors at the Date of the Report is illustrated below, the reader is reminded that the Board will fall from office at the approval by the Shareholders 'Meeting of the Financial Statements closed as of 31 December 2011 after completing its mandate:

NAME	OFFICE	IN OFFICE IN THE COMMITTEE FROM	LIST	INDEP. SELF- REGULATORY CODE	% ATTENDANCE BOD	% ATTENDANCE S.C.	% ATTENDANCE CICRCG	% ATTENDANCE R.C.	% ATTENDANCE APPOINTMENT C.
Enrico Laghi	Chairman	21/04/2009	Major.	X	100%	100%	90%	100%	100%
Paolo Gualtieri	Statutory Auditor	21/04/2009	Major.	X	86%	75%	70%	33%	
Paolo Domenico Sfameni	Statutory Auditor	21/04/2009	Major.	X	100%	100%	100%	100%	
Luigi Guerra	Alternate Auditor		Major.						
Franco Ghiringhelli	Alternate Auditor		Major.						

Legend

Office: indicates whether Chairman, Statutory Auditor, or Alternate Auditor.

List: Major./Minor. depending on whether the auditor was elected from the list voted by the majority, or by a minority (Article 144-decies of the Issuers' Regulations).

Indep.: if crossed, this means that the auditor can be qualified as independent, in accordance with the criteria established by the Self-Regulatory Code, clarifying at the bottom of the table whether these criteria were supplemented or changed.

% attendance in S.C.: indicates the presence, in percentage terms, of the auditor in the meetings of the Board of Statutory Auditors.

% attendance in BoD: indicates the presence, in percentage terms, of the auditor in the meetings of the Board of Directors.

% attendance in CICRCG: indicates the presence, in percentage terms, of the auditor in the meetings of the Committee for Internal Control, Risks and Corporate Governance.

% Appointments C.: indicates the presence, in percentage terms, of the auditor in the meetings of the Appointments and Succession Committee.

% R.C.: indicates the presence, in percentage terms, of the auditor in the meetings of the Remuneration Committee.

It is important to remember that the Chairman of the Board of Statutory Auditors is invited to participate in the activities of the Appointments and Succession Committee and the foregoing Chairman may also be invited to participate in the activities of the Strategies Committee. In this regard, it is important to observe that the Chairman of the Board of Statutory Auditors also attended all the meetings of the Strategies Committee which he was invited to attend.

ANNEX A

List of principal offices held by Directors in other Companies not included in the Pirelli Group.

Marco Tronchetti Provera	Marco Tronchetti Provera S.a.p.A.	General Partner
	Camfin S.p.A.	Chairman
	Gruppo Partecipazioni industriali S.p.A.	Chairman
	Prelios S.p.A.	Chairman
	Mediobanca S.p.A.	Deputy Chairman
	F.C. Internazionale Milano S.p.A.	Director
	Alitalia Compagnia Area Italiana	Director
	Eurostazioni S.p.A.	Director
Vittorio Malacalza	HOFIMA S.p.A	Chairman
	Malacalza Investimenti S.r.l.	Chairman
	Camfin S.p.A.	Director
	Rcs Mediagroup S.p.A.	Director
	Cassa di Risparmio della Spezia S.p.A.	Director
Alberto Pirelli	Gruppo Partecipazioni industriali S.p.A.	Director
	Camfin S.p.A.	Director
	KME S.p.A.	Director
Carlo Acutis	Vittoria Assicurazioni S.p.A.	Vice Presidente
	Banca Passadore S.p.A.	Deputy Chairman
	YAFA S.p.A.	Director
	YAM INVEST	Member of Supervisory Body
Anna Maria Artoni	Artoni Group S.p.A.	Sole Administrator
	Carraro S.p.A.	Director
	Cariparma	Director
Gilberto Benetton	Edizione S.r.l.	Chairman
	Atlantia S.p.A.	Director
	Autogrill S.p.A.	Chairman
	Benetton S.p.A.	Director
	Mediobanca S.p.A.	Director
	Allianz S.p.A.	Director
Alberto Bombassei	Brembo S.p.A.	Chairman and Chief Executive Officer
	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.c.p.A.	Director
	Pioneer Investment Management S.p.A	Director
Luigi Campiglio	Allianz Bank Financial Advisor	Director
Paolo Ferro-Luzzi	Servizio Italia S.p.A.	Chairman
	Banknord SIM S.p.A.	Chairman
	Prelios Sgr	Chairman
	Prestitalia S.p.A.	Chairman

Pietro Guindani	Vodafone Omnitel NV	Chairman
	Carraro S.p.A.	Director
	Sorin S.p.A.	Director
	Assonime	Director
Giulia Maria Ligresti	Fondazione Fon-SAI	Chairwoman
	Premafin Finanziaria S.p.A.	Chairwoman and CEO
	Finadin S.p.A.	Director
	SAI HOLDING ITALIA S.p.A.	Chief Executive Officer
	SAIFIN S.p.A.	Chairwoman
	Ssinternational SA	Director
Elisabetta Magistretti	Mediobanca S.p.A.	Director
	Unicredit Audit	Director
	Unicredit Logistics	Director
	Zao Unicredit Russia	Member of the Supervisory Board
Massimo Moratti	F.C. Internazionale Milano S.p.A.	Chairman
	SARINT S.A.	Chairman
	SARAS S.p.A. Raffinerie Sarde	Chief Executive Officer
	GUT Edizioni S.p.A.	Director
	Angelo Moratti di Gian Marco Moratti e Massimo Moratti & C. S.a.p.A.	Chairman
Renato Pagliaro	Mediobanca S.p.A.	Chairman
	Telecom Italia S.p.A.	Director
	RCS MediaGroup S.p.A.	Deputy Chairman
	Istituto Europeo di Oncologia s.r.l.	Statutory Auditor
Giovanni Perissinotto	Assicurazioni Generali S.p.A.	Chief Executive Officer
	Fiat Industrial S.p.A.	Director
	Banca Generali S.p.A.	Chairman
	Ina Assitalia S.p.A.	Director
Luigi Roth	Terna S.p.A.	Chairman
	Banca Popolare di Roma S.p.A.	Chairman
	Meliorbanca S.p.A.	Director
	Autostrada Torino – Milano S.p.A.	Director
Carlo Secchi	A2A	Member of the Management Board
	Allianz S.p.A.	Director
	Italcementi S.p.A.	Director
	Mediaset S.p.A.	Director
	EXPO 2015 S.p.A.	Director
Manuela Soffientini	Philips S.p.A.	Director
Giuseppe Vita	Allianz S.p.A.	Chairman
	Banca Leonardo S.p.A.	Chairman
	Barilla S.p.A.	Director
	Humanitas S.p.A.	Director
	Axel Springer AG	Member of Supervisory Board

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:

	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.

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.

buy or sell the shares.

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, 2013 and shall be tacitly renewed for a period of three years 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, 2 July 2011

The illustration contained in the three volumes of the Annual Report
are all the work of Stefan Glerum

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