

HALF YEARLY REPORT ON CORPORATE GOVERNANCE AND SHARE OWNERSHIP

Pirelli & C. has adhered to the Self Regulatory Code of Borsa Italiana¹ since it was first issued. In the March 2007, it formalised its adhesion to the new release of the same Code².

The Company is aware of the importance of an efficient and effective Corporate Governance system in fulfilling its objective of creating value and making progress in sustainable development, and this induces the Company to keep its own corporate governance system constantly in line with national and international *best practices*.

The Company adopts the traditional administration and control model, founded on the central role of the Board of Directors, on the presence of consolidated disclosure practices regarding the choices and the procedures for decision-making within the Company, on an effective system of internal controls, on effective rules about potential clashes of interest and on an adequate code of conduct for transactions with related parties.

The system of *governance* is documented in the Code of Ethics, the Company Bylaws, the regulations regarding shareholders' meetings, and a series of principles, rules and procedures (periodically updated and available on the Company website)³ and in the approach and policies of the Board of Directors.

In accordance with *best practice*, Pirelli is publishing this Half Yearly Report on Corporate Governance and Share Ownership (the "Report") to inform about the principal amendments and additions made in the first half of the financial year to the date of this report, to the corporate governance system as described in the Annual

¹ Published in July 2002.

² Published in March 2006, an updated version of which is available on the website www.borsaitaliana.it

³ Cf. www.pirelli.com, *Governance* section

Report on *Corporate Governance* published with the financial statements.

On 15 July 2010 the shareholders meeting resolved to reduce the share capital by 178,813,982.89 euros. Regarding this, it should in fact be recalled that the transaction to separate Pirelli RE from the Pirelli Group by assigning almost all the ordinary shares of Pirelli & C. Real Estate S.p.A. held by the Company, equivalent to approximately 58% of the share capital, to the shareholders of Pirelli & C. S.p.A. to be implemented by reducing the share capital by an amount equivalent to the value of the shareholding in Pirelli & C. Real Estate, determined, in turn, by the official price of the Pirelli RE shares (0.367 euros) on 14 July 2010, the Italian Stock Exchange trading date immediately before the Shareholders' Meeting .

The execution of the capital reduction transaction may only take place, pursuant to article 2445, subsection 3 of the Italian Civil Code, once a period of ninety days has elapsed since the resolution of the Extraordinary Shareholders' Meeting of Pirelli & C. was registered in the Business Register, provided that no creditor of the company prior to the registration has opposed the operation within this period. Pursuant to article 2445, subsection 4 of the Italian Civil Code, if oppositions are filed within this period, the Court may order that the transaction should still take place if it believes the detriment for the creditors is unfounded or if the Company has provided suitable guarantee.

The same Shareholders' Meeting of 15 July 2010 also resolved:

- the cancellation of the par value of the ordinary and savings shares of the Company, which thus will remain unexpressed;
- the reverse split of the ordinary and savings shares of the Company in the ratio of 1 new ordinary or savings share for every 11 shares of the same category held, after cancellation of 1 ordinary share and 8 savings shares with a corresponding reduction in capital of 2.61 euros, solely for the purpose of completing the reverse split operation. (the reverse split operations started on 26 July 2010).

After the reverse split and cancellation of the par value, the share capital of Pirelli & C.,

equal to 1,556,692,862.67 euros, is composed of a total of 487,991,493 shares with no declared par value, of which 475,740,182 (1,517,611,180.58 euros) ordinary shares and 12,251,311 (39,081,682.09 euros) savings shares.

As a consequence of the aforementioned resolutions, the meeting, among other things, resolved to amend article 18 of the Company Bylaws concerning the distribution of profits. In particular, it specifies that the net annual profits are divided as follows, after the legal allocations have been made: a) savings shares are attributed a sum totalling seven percent of 3.19 euros; if a dividend of less than seven percent of 3.19 euros has been assigned to the savings share in a financial year, the difference is calculated by increasing the privileged dividend in the two subsequent years; the profits remaining after assignment of the above dividend to the savings shares are split between all the shares so that the savings shares are entitled to a total dividend that is two percent of 3.19 euros higher than the dividend payable to the ordinary shares; b) without prejudice to the above provisions concerning the increased total dividend payable on savings shares, ordinary shares are attributed a sum totalling five percent of their accounting parity value (understood to be the total share capital divided by the total number of shares issued).

The remaining profits will be distributed to all the shares, in addition to the sums assigned as described in letters a) and b) above, unless the shareholders' meeting should decide to approve the Board's proposal to make special allocations to extraordinary reserves or other uses, or should carry forward part of said share of the profits.

As already described in the Annual Report on *Corporate Governance*, the Shareholders' Meeting of 21 April 2010 approved some modifications to the bylaws related to the introduction, into Italian Law, of the regulations implementing Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

Specifically, the Shareholders' Meeting approved the proposal to modify subsection 4 of article 7 of the Company bylaws, specifying that the shareholders' meeting to approve the financial statements may be called – pursuant to article 2364 of the Italian Civil Code – within 180 days of the end of the financial year. The Shareholders' Meeting also approved the proposal to reduce (from 2% to 1.5%) the share capital rate required by the Bylaws for the submission of slates for the renewal of the Board of Statutory Auditors, for the purpose of further facilitating the submission of lists by “minorities”.

The Company took note of the provisions of Legislative Decree 39/2010 (the so-called Consolidated Audit Law, which implemented Directive 2006/43/CE on statutory audits of the annual accounts and consolidated accounts in Italy. In particular, the Company immediately implemented the provisions that came into force after the ordinary *vacatio legis*⁴, acknowledging that the full effectiveness of many of the other provisions of the aforementioned Consolidated Law depends on the issue of implementing regulations, and that the provisions that have governed the matter up to now continued to be applied, insofar as they were compatible.

Although the Committee for Internal Control is an internal advisory body of the Board of Directors, and the Board of Statutory Auditors is itself a control body, it nevertheless proved necessary to coordinate the activity of the two bodies even before the Consolidated Law comes into force.

In this sense, Pirelli has for some time expected the entire Board of Directors to have the right to participate in the activities of the Committee for Internal Control. The Board of Directors and the Board of Statutory Auditors agreed that the exchange of information between the two bodies already permits effective coordination.

⁴ the deferment of the coming into force of a law

External auditors Reconta Ernst & Young S.p.A. informed the Company that from 25 June 2010 Mr. Pietro Carena has taken the place of Mr Pellegrino Libroia as partner responsible for the external audit of Pirelli & C. S.p.A..

After the Consob Regulation on transactions with related parties, the Company immediately started the research necessary to draft the procedures prescribed in this Regulation and the Board of Directors, having determined that its composition is coherent with the requirements of the Regulation, has identified the Committee for Control Risks and Corporate Governance as the committee called on to express an opinion of the procedure itself and, subsequently, on the transactions that exceed a specific threshold of relevance.

The work to implement the “new” model for managing company risks which was extensively reported on in the Annual Report on Corporate Governance and Share Ownership continues. In particular, the risk assessment activity started by the Risk Management Committee is reaching completion; subject to the approval of the Committee for Control Risks and Corporate Governance, this will lead to the formulation of the *Annual Risk Assessment and Management Plan*.

The tools and arrangements for managing the risks of the characteristic activity of the company have been illustrated to all directors in a specific extra-board work session, taking an important business profile, raw materials procurement, as an example.

Lastly, it seems opportune to give an account of the evolution of the criminal proceedings pending before the Milan Court, involving two ex-managers of the Security division of the Company, as explained in previous Corporate governance Reports, and which has been constantly monitored by the Board of Directors and the Committee for Internal Control, Risks and Corporate Governance, together with the Board of Statutory Auditors and the Supervisory Body.

In particular, the Judge for the Preliminary Hearing in Milan has declared his approval of the application for settlement proposed by the Company with the consent of the Office of the Public Prosecutor.