

HALF YEARLY REPORT ON CORPORATE GOVERNANCE

Pirelli & C. has adhered to the self-regulatory code of the Italian Stock Exchange ¹ since its first issue, and later, in March 2007 it formalised its adhesion to the new version of the code².

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

The Company uses the traditional administration and control model, founded on the central position of the Board of Directors, based 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 careful monitoring for potential clash of interests and on a rigorous 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, that are available on the Company website ³ and the approach and policies of the Board of Directors.

In accordance with best practice, Pirelli is publishing this report with its half-yearly financial report, to demonstrate 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 Report on Corporate Governance.

¹ Published in July 2002

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

³ Cf. www.pirelli.com Governance section.

The Shareholders' Meeting held on 21 April 2009 appointed the new Board of Statutory Auditors for the three year period 2009-2011 using the slate system. The members of the Board are: Enrico Laghi (who the Meeting appointed as Chairman), Paolo Domenico Sfameni and Paolo Gualtieri as Standing Auditors, and Luigi Guerra and Franco Ghiringhelli as Alternate Auditors. The members of the new Board of Statutory Auditors were selected from the single slate submitted by the members of Pirelli & C. S.p.A. Block Shares Syndicate. The fees of 41,500 euros for Standing Auditors and 62,000 euros for the Chairman of the Board of Statutory Auditors were confirmed.

The curricula vitae of the new Standing Auditors are available on the company website ⁴.

After the Shareholders' Meeting had renewed the Board of Statutory Auditors and confirmed the appointment of Paolo Domenico Sfameni as Statutory Auditor, the Board of Directors confirmed him as a member of the Supervisory Body, which therefore consists of:

- Carlo Secchi (Chairman);
- Paolo Domenico Sfameni;
- Maurizio Bonzi.

Given both best practices and our experience so far, the Board of Directors redefined the remuneration and composition of the two existing board committees, with the approval of the Committee for Internal Control and Clinical Government.

In particular, the Company considered it appropriate to adopt a risk governance model that is anticipatory and proactive, rather than reactive, focussed on identifying risks before they arise, ensuring that appropriate choices are made and tools adopted that can reduce their impact, and manage them effectively. In line with best practice, and based on the notions contained in the international standards developed for Corporate Governance, the Company attributed the responsibilities to the Committee for Internal Control and Corporate Governance, in addition to its responsibilities for Internal Control and Corporate Governance,

⁴ Cf. www.pirelli.com.

renaming the Committee the Committee for Internal Controls, Risks and Corporate Governance. The additional tasks are:

- to assist the Board of Directors in identifying and assessing the most significant risks, meaning those risks whose risks could prejudice or constitute an obstacle to the achievement of the objectives of the business;
- to express an opinion to the Board of Directors on the adequacy of risk management, given the Annual Risk Assessment and Annual Risk Management plan drawn up by Company management;
- to report at least twice a year to the Board of Directors and Board of Statutory Auditors on the activity carried out;
- to provide opinions on specific aspects inherent to the identification and management of the principal business risks.

The Company has also created the role of Risk Officer, who – in possession of adequate professional qualifications, independence and authority – is charged with collecting and analysing information on the existing and prospective, internal and external risks to which the Group is exposed, submitting them to the management Risk Committee for consideration. The latter Committee, a further new body:

- participates in defining the methods used to measure risks;
- participates in defining the operating limits assigned to business structures, and defines the procedures for the timely monitoring of these limits;
- examines information on the existing and prospective, internal and external risks to which the Group is exposed;
- supports the executive Director responsible for supervising the operation of the internal control system in its execution of the tasks assigned to it in accordance with the recommendations of the Self Regulatory Code;
- monitors the application of the risk management policy so as to ensure that risk is reduced to “acceptable” levels;
- checks that the nature and level of insurance cover is adequate.

The Company has also created a Group Compliance function with the following specific responsibilities:

- a) to continually identify the legal regulations that apply to the Company and the Group, and assess their impact on business processes and procedures;
- b) to assist the competent functions to identify and define the organisational and procedural solutions needed to ensure adequate risk management;
- c) to assess the adequacy and efficacy of the organisational measures adopted to prevent the risk of regulatory non-compliance;
- d) to arrange adequate flows of information to the decisional bodies of the enterprise and the other structures involved.

The Compliance function reports every three months to the Committee for Internal Control, Risks and Corporate Governance and the Board of Statutory Auditors on the activities it has undertaken.

Also as a result of the above changes to Company corporate governance arrangements, the Board of Directors resolved to enlarge the Committee for Internal Control, Risks and Corporate Governance. The three members currently serving have been joined by Directors Cristiano Antonelli and Luigi Roth.

The Committee for Internal Control and Corporate Governance, and the Remuneration Committee therefore now has the following members:

- Carlo Secchi (Chairman);
- Carlo Angelici
- Cristiano Antonelli
- Franco Bruni
- Luigi Roth

The annual fee for membership of the Committee was also redetermined, now amounting to 24 thousand euro.

The Board of Directors further resolved to enlarge the Remuneration Committee.

The three members currently serving have been joined by Director Umberto Paolucci. The Remuneration Committee now has the following membership:

- Berardino Libonati (Chairman);
- Alberto Bombassei
- Giampiero Pesenti
- Umberto Paolucci

The composition of the Committees again confirms that their membership is drawn from among the independent directors only.

During the first half of the year, the Pirelli Group has also adopted a specific procedure for reporting suspected violations of laws or regulations, of the principles of the Group's Code of Ethics, the procedures used in our business or the system of internal control (whistleblowing), which guarantees people reporting such matters will not suffer detrimental consequences.

It should also be noted that in May 2009, "*GMI - Governance Metrics International*" (valutata "*Top Corporate Governance Research Firm*" part of the *Thomson Reuters Extel Survey* 2009 and the only independent corporate governance research company included in the 10 ten) judged the Pirelli & C corporate governance model the leader in Italy and in its industrial sector (*Automobiles & Parts*).

Pirelli was in fact the only company in Italy to receive a national rating of 10/10 for its corporate governance (the last *GMI Country Ranking* of September 2008 assigned an average rating of 5.32/10 to Italy). Pirelli was also rated 9/10 on a world basis, the highest rating in the "*Automobiles & Parts*" sector (the mean rating of *Automobiles & Parts* sector companies is 5/10).

These flattering results confirm the particular attention Pirelli has always paid to its corporate governance system, always quick to incorporate national and international best practice, reflecting its policy of continuous improvement.

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 and Corporate Governance, together with the Board of Statutory Auditors and the Supervisory Body.

In particular, as already made public, the Company applied to bring a civil action (parte civile) against all the persons accused of the crimes which have caused damage or offence to the company. The Company was permitted to bring a civil action in the criminal proceedings for embezzlement and money laundering.

The only civil action that has been permitted to be brought against the Company, the legally accused person pursuant to law 231/2001, is that brought by the Avvocatura dello Stato, the pool of specialised jurists who defend state and other public bodies, in the interest of the Office of the Prime Minister and the Ministries to which the public official involved in the corruption proceedings belong. The Company has also noted the request, by the parties allegedly damaged by the conduct of its ex-employees, for proceedings to be brought against it for civil liability. Such compensatory action is in fact founded in the legal provision by virtue of which the employer, irrespective of its culpability, is answerable financially for the illicit acts committed by its employees. So Pirelli would be called on the answer only for its objective liability.

It should be noted that the Company is proceeding with the civil actions started against the security service suppliers involved in the investigations in order to be compensated for services that were not contractually fulfilled or were even illegal.

The Board of Directors

Milan, 29 July 2009