

HALF-YEARLY CORPORATE GOVERNANCE REPORT

Pirelli & C. has adhered to the Self Regulatory Code by Borsa Italiana, the Italian Stock Exchange, (published in July 2002), since its first issue, and in the Board meeting of 12 March 2007 it formalised its adhesion to the new self-regulatory code for listed companies (published in March 2006)

Awareness of the important role played by the Company's *corporate governance* system in meeting the targets of value creation for all shareholders, and for the sustainable development of the business, prompts the Company itself to maintain its corporate governance system constantly in line both with ongoing regulatory developments and with Italian and international *best practice*.

The Company adopts the traditional administration and control model based on the centrality of the Board of Directors, the presence of correct *disclosure* practice concerning the choices and the processes by which company decisions are made, on an effective internal control system, on an effective regulation of potential conflicts of interest, as well as on rigorous rules for the conduct of transactions with related parties.

The system of *governance* is documented in the Code of Ethics, in the Company Bylaws, in the Regulations regarding shareholders' meetings, and in a series of principles, rules and procedures, periodically updated to reflect regulatory changes, that are available on the website of the Company at www.pirelli.com under the section dedicated to the *Governance*, and in the policies and guidance of the Board of Directors.

In this half-yearly report, the Company intends to highlight the main updates and additions made during the current year and up to the date of this report to its corporate governance system since the last annual report.

Structure of the share capital

The Share capital is divided into ordinary shares and savings shares; the table below shows its exact composition.

	N°. of shares	% of share capital	Listing
Ordinary shares*	5,233,142,003	97.49%	Listed on the MTA (Mercato Telematico Telematic Stock Market) organised and managed by Borsa Italiana S.p.A. – Blue Chip segment
Savings shares**	134,764, 429	2.51%	Listed on the MTA (Mercato Telematico Telematic Stock Market) organised and managed by Borsa Italiana S.p.A. – Blue Chip segment

* Identification code ISIN IT0000072725

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At the date of this report, the share capital of Pirelli & C S.p.A. totals Euro 1,556,692,865.28, consisting of 5,367,906,432 shares of 0.29 euros par value, of which 5,233,142,003 ordinary shares and 134,764,429 non-convertible savings shares.

The share capital may be increased up to a maximum of Euro 1,572,418,361.78 par value by the issue of a maximum of 54,225,850 ordinary shares of 0.29 euros par value each, at a price of 0.996 euros each, of which Euro 0.706 as share price premium, against the possible exercising of the options granted to managers and executives of the company, its subsidiaries and the companies controlled by these latter as part of the stock option plans called “Pirelli to People” and “Group Senior Executives”, already deliberated by the merged company Pirelli S.p.A. in 2001.

So far as the Company is aware, there are no subjects who could exercise control over it pursuant to article 93 of Legislative Decree no. 58 of 24 February 1998 (the Testo Unico della Finanza, or consolidated Financial Services Act – hereafter the FSA.).

Participants in the “Pirelli & C. S.p.A. Block Share Syndicate”, the purpose of which is to ensure Pirelli & C. share structure stability, and an excerpt of the relevant agreement are available on the website of the Company at www.pirelli.com.

Authorisations to purchase own shares

In its meeting on 9 May 2008, the Board of Directors, implementing the authorisation received from the Shareholder’s Meeting held on 29 April 2008, approved a programme to purchase its own shares, the principles and characteristics of which have been reported to the market¹.

At the date of this Report, the Company holds 2,617,500 of its own ordinary shares and

4,491,769 of its own savings shares.

COMPANY BYLAWS

As communicated in the Annual Corporate Governance Report for 2007, a Shareholders’ Meeting held on 29 April 2008 approved – in its extraordinary session - some changes to the Company Bylaws.

The current text of the Company Bylaws is available on the company website www.pirelli.com.

Shareholders Meetings

The Shareholders’ Meeting approved the modification of article 7 of the company bylaws, to incorporate the variations made to the FSA by Legislative Decree no. 195 of 6 November 2007, incorporating directive 2004/109/EC concerning the harmonisation of the requirements for transparency in information on issuer whose securities are traded in a regulated market. Specifically, listed companies may no longer benefit from the possibility envisaged in subsection two of article 2364 of the

¹ Press release issued on 9 May 2008 available on the company internet website www.pirelli.com Media section.

Civil Code to derogate from the period of one hundred and twenty days for the approval of the financial statements by the Shareholders' Meeting.

Appointment and replacement of directors

The Shareholders' Meeting also approved some additions to the provisions concerning the election of the Board of Directors, ensuring that, if the voting slate mechanism does not assure the minimum number of independent directors, the non-independent candidate elected with the highest progressive number of votes on the slate with the highest number of votes should be replaced by the unelected independent candidate from the same slate according to the progressive order of presentation and so on, slate by slate, until the minimum number of independent directors has been achieved.

The Board of Statutory Auditors

Finally, some changes were made on the subject of the election of members of the Board of Statutory Auditors, to refine and clarify the text of the bylaws and to take into account the changes made to Article 144-sexies, subsection 5 of the Issuer Regulations approved by Consob under Resolution no. 11971 of 1999.

MANAGEMENT AND CO-ORDINATION ACTIVITIES

It should be noted that, in its meeting on 29 April 2008, the Board of Directors confirmed that, while the Company - pursuant to article 2359 of the Civil Code - controls Pirelli & C. Real Estate S.p.A., a company listed on the Milan stock exchange, and consolidates its results, it does not exercise direction and coordination activities over it, since, as reported in the Annual Corporate Governance Report for 2007, there is no evidence to show that it has any effective impact on the management of this subsidiary.

BOARD OF DIRECTORS

The Board of Directors plays a central role in the *corporate governance* system of the Company, and holds the power (and the obligation) to guide the activities of the Company, pursuing the final and primary objective of creating value for its shareholders.

In fact, pursuant to the Bylaws, the Board manages the business and is invested for this purpose with the widest administrative powers, excepting those which according to the law and the bylaws themselves are held by the Shareholders' Meeting.

The Board of Directors of the Company, as established by the bylaws, consists of no less than seven and no more than twenty-three members, who serve for three years (unless a lesser period is specified by the shareholders' meeting upon their appointment) and may be re-appointed.

The mandate of the Board of Directors appointed by the shareholders' meeting of 28 April 2005 ended on approval of the financial reports for the year ending 31 December 2007.

In its meeting on 29 April 2008, the Shareholders' Meeting decided that the new Board of Directors shall be composed of 20 directors and shall serve for three years, to expire at the shareholders' meeting called to approve the financial reports for the year ending 31 December 2010.

With the methods and within the terms specified in article 10 of the Company Bylaws, and in accordance with the recommendation of the Self Regulatory Code of the Italian stock exchange, two slates were presented to the shareholders' meeting held on 29 April 2008: one from the participants in the Pirelli & C. Share Block Syndicate and another one from a group of institutional investors. Those proposing the slates made the candidates' profiles available so that the candidates' personal and professional characteristics, as well as some candidates' qualifications as independents, were made known prior to voting. The *curricula vitae* presented when the slates were filed were promptly published on the *Governance* section of the company website, www.pirelli.com.

To respect the best national and international corporate governance practice, the Company allowed the shareholders to vote separately on the following matters when the Board of Directors of the company was being renewed: (i) the determination of the number of directors, (ii) the appointment of directors by voting on the slates presented (iii) the determination of the duration for which the Board of Directors should serve, and (iv) the determination of the remuneration due to directors.

By voting on a slate the minority shareholders were able to nominate four directors, i.e. one fifth of the total number (specifically, Carlo Angelici, Cristiano Antonelli, Franco Bruni and Umberto Paolucci).

The current composition of the Board of Directors, in addition to being reported at the beginning of the publication containing this Half-yearly Corporate Governance report, is also available in the *Governance* section of the Company website www.pirelli.com.

Corporate Governance Tools

It is appropriate to report that the Board of Directors, in the first meeting it held after its appointment, confirmed the validity and applicability of the principal tools of Corporate Governance adopted by the company, as reported at the end of the Annual Corporate Governance Report for 2007 and/or on the company website www.pirelli.com, and specifically:

- Organisational Model 231/2001;
- “Policy of the Board of Directors on the maximum number of appointments considered compatible with effective service as a director of the Company”;
- “Procedure for Information Flows to Directors and Auditors”;
- “Rules of Conduct for Transactions with Related Parties”;
- “Procedure for the Management and Public Disclosure of Inside Information”;
- “Insider dealing – black out periods”.

The Board also confirmed that, without prejudice to the responsibilities and powers reserved to it by law, the bylaws, the balance of delegated powers and internal procedures, it is the right of the Board of Directors to approve certain non intragroup transactions (determined on the basis of further qualitative criteria and further quantitative thresholds) in advance, when undertaken by Pirelli & C. or companies, including unlisted and foreign companies, that are subject to the direction and control of Pirelli & C..

DELEGATED BODIES

Chairman

After its renewal, the Board of Directors confirmed Marco Tronchetti Provera as Chairman of the Board of Directors.

The Chairman is recognised as the legal representative of the Company, empowered to perform any action pertinent to corporate activity in its various manifestations.

The Board of Directors has identified the limits to the powers it confers, which have been defined as the inner limits of the relationship between the delegating body of the Board and the subject with delegated powers. In particular, the following inner limits have been identified for the Chairman: the power to guarantee Company and subsidiary bonds having individual values of more than 25 million euros, or for third parties regarding bonds with individual values of more than 10 million euros (in the latter cases another General Manager must co-sign with the Chairman);

Furthermore, the Board confirmed that the Chairman, Marco Tronchetti Provera, should exercise the following organizational functions:

- relations with shareholders and the information provided to them;
- formulation of the general strategies and development policy for the Company and the Group together with extraordinary corporate actions to be submitted to the Board of Directors;
- proposals for the appointment of General Managers and, after consulting the Remuneration Committee, for their remuneration, to be submitted to the Board of Directors;

- chairmanship of the management committees with strategic functions;
- coordination of the activities of Managing Directors, where appointed;
- all forms of communication to the market, with the right to delegate to the managing directors, where appointed.

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OTHER EXECUTIVE DIRECTORS

After its renewal, and in coherence with the previous mandate, the Board of Directors considered the two Vice-Chairmen, Carlo Alessandro Puri Negri and Alberto Pirelli, as executive directors, in addition to the Chairman of the Board of Directors, Marco Tronchetti Provera, also in relation to the offices they hold in some of the major subsidiary companies.

NON-EXECUTIVE DIRECTORS AND INDEPENDENT DIRECTORS

The Board of Directors of the Company determined that, on the basis of the information provided by the Directors and that available to the Company, eleven directors who were qualified as independent-(Carlo Acutis; Carlo Angelici; Cristiano Antonelli, Alberto Bombassei, Franco Bruni, Luigi Campiglio, Berardino Libonati, Umberto Paolucci, Giampiero Pesenti, Luigi Roth e Carlo Secchi), upon their appointment have the requisites for independence specified in the Self Regulatory Code and the FSA. A further six Board members (Gilberto Benetton, Enrico Tommaso Cucchian, Giulia Maria Ligresti, Massimo Moratti, Renato Pagliaro and Giovanni Perissinotto) could be qualified as non-executive directors. It follows that the percentage of independent directors on the Board as currently composed is 55%. In accordance with the recommendations of the Self Regulatory Code, the Board of Statutory Auditors has checked that the criteria and ascertainment procedures adopted by the Board to assess the independence of its members have been correctly applied.

LEAD INDEPENDENT DIRECTOR

After the renewal of the board, the designation of Carlo Secchi, the Chairman of the Committee for Internal Control and *Corporate Governance*, as *Lead Independent Director*, the point of reference and coordination for the requests and contributions of the independent Directors, has been confirmed. The rights of the *Lead Independent Director* include the right to convene - on his own initiative or upon the request of other Directors – specific meetings solely for independent Directors in order to discuss subjects occasionally felt to be of interest to the functioning of the Board of Directors or to the management of the company. And last but not least, it should be noted that the *Lead Independent Director* works with the Chairman of the Board of Directors for the better functioning of the Board of Directors.

BOARD COMMITTEES

In its meeting on 29 April 2008, the Board of Directors confirmed the institution of two subcommittees: the Internal Control and *Corporate Governance* Committee and the Remuneration Committee.

The Board gave the Committee for Internal Control and *Corporate Governance* the power to identify candidates to propose to the Board in the event that an independent Director is replaced pursuant to article 2386, subsection 1 of the Civil Code.

REMUNERATION COMMITTEE

In full compliance also with the provisions of the Self Regulatory Code, the Remuneration Committee, appointed by the Board of Directors in its meeting on 29 April 2008, is composed solely of independent Directors:

- Berardino Libonati (Chairman);
- Alberto Bombassei;
- Giampiero Pesenti.

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

The Board of Directors confirmed the investigation and consultation functions of the Remuneration Committee attributed to it in the preceding mandate, as specified in the Self Regulatory Code.

REMUNERATION OF DIRECTORS

In addition to reimbursement for expenses incurred in performing their duties, Directors are entitled to annual fees determined by the shareholders' meeting.

The meeting of 29 April 2009 confirmed the maximum of 1,200,000 euros as the total annual compensation of the Board of Directors pursuant to Art. 2389, subsection 1, of the Civil Code, said amount to be distributed among its members in accordance with the decisions taken in this regard by the Board.

At the same meeting, on 29 April 2008, the Board of Directors established the distribution of the fee as follows:

- 50,000 euros per annum for each of the members of the Board of Directors;
- 25,000 euros per annum for each of the members of the Committee for Internal Control and *Corporate Governance*;
- 20,000 euros per annum for each of the members of the Remuneration Committee,

reserving the right to use the residual amount (65,000 euros) in the future, to give the Board a margin of organizational flexibility, including for the adoption of any new *governance* solutions.

A fee 15,000 euros per annum is also made to the Board member called on to be a member of the Supervisory Body as per legislative decree no. 231/2001 (Carlo Secchi).

The remuneration for directors given particular tasks is established by the Board of Directors, upon consultation with the Board of Statutory Auditors, as proposed by the Remuneration Committee. The current remuneration system provides for payments to comprise a fixed amount and an additional bonus linked to the performance of the Group, and to be related to the attainment of specific objectives set by the Board

THE COMMITTEE FOR INTERNAL CONTROL AND *CORPORATE* *GOVERNANCE*

In line with best practices and in full compliance with the recommendations in the Self Regulatory Code, the Board of Directors in its meeting on 29 April 2008 appointed the following exclusively independent Directors as members of the Committee:

- Carlo Secchi (Chairman);
- Carlo Angelici;
- Franco Bruni

two of whom ², as ascertained by the Board of Directors that appointed them, possess adequate accounting and financial experience.

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

Similarly to the Remunerations Committee, the Board of Directors determined the tasks required of the Committee for Internal Control and Corporate Governance in line with those specified in the Self-Regulatory Code, and also provided that the Committee should continue to maintain the *corporate governance* prerogatives that have characterised it since its establishment.

² Specifically, Mr Bruni and Mr Secchi.

INTERNAL CONTROL SYSTEM

Executive director responsible for the internal control system and Internal Control Officer

After its renewal, the Board of Directors confirmed the Chairman of the Board of Directors as the executive director responsible for the Internal Control system charged with supervising the operation of the internal control system, attributing to him responsibilities in line with the recommendations of the Self Regulatory Code of the Italian stock exchange.

As proposed by the executive director responsible for supervising the operation of the internal control system, with the approval of the Committee for Internal Control and *Corporate Governance* and in accordance with *best practice*, the Board of Directors confirmed the head of the Internal Audit Department (Maurizio Bonzi) as internal control officer, who reports to the Committee for Internal Control and *Corporate Governance* and the Board of Statutory Auditors and hierarchically refers to the Chairman of the Board of Directors.

Organizational Model (ex. Legislative Decree 231/2001)

In its meeting held on 29 April 2008, the Board of Directors appointed the Supervisory Body, the mandate of which had ended with that of the Board of Directors that had appointed it (approval of the financial reports for the financial year ended 31 December 2007).

The Board of Directors, in confirming the attribution to the Supervisory Body of the tasks and powers established in the Company Organisational Model, and in attributing to it full economic and organisational independence, not subject to limits of expenditure, appointed Carlo Secchi, the *Lead Independent Director* and Chairman of the Committee for Internal Control and *Corporate Governance*, Paolo Sfameni, a member of the Board of Statutory Auditors, and Maurizio Bonzi, head of the Internal Audit Department and internal control officer in accordance with the structure specified in the Organisational Model, for the duration of the mandate of

the Board of Directors as members of the Supervisory Body. Carlo Secchi was confirmed as Chairman of the Supervisory Body. Each member of the Statutory Body was awarded a net fee of 15,000 euros net per annum.

It is considered appropriate to give an account of the development of the court case that implicated two ex-heads of the Security Department of the Company, to which reference was made in the Annual Corporate Governance Report for 2007. In particular, it should be noted that the Company has received formal notice that the investigations concerning the pending case before the Milan Criminal Court relating to the activities of the *Security* department (Case no. 30382/03) have been concluded.

Pirelli & C. has taken note of its formal inclusion in the register of investigated persons based on legislative decree 231/2001, and of the fact that it is at the same time an injured party in the same case.

The Company will continue to collaborate with the legal authorities, as in the earlier preliminary investigations, and is certain that it will be able to define its position in this case, and proceed to bring a civil action in the criminal proceedings.

The Committee for Internal Control and *Corporate Governance*, the Supervisory Body and the Board of Statutory Auditors were promptly informed of the circumstance.

External Auditors

With the approval of the 2007 financial statements, the three-year mandate appointing PriceWaterhouseCoopers S.p.A. (and the companies that are part of its network) as external auditors of the accounts of the Pirelli & C. S.p.A. group given by the Shareholders' Meeting on 28 April 2005 has expired. Pursuant to current regulations, this mandate could not be renewed again.

Pursuant to article 159 of the FSA, the shareholders' meeting held on 29 April 2008 appointed Reconta Ernst & Young SpA as external auditors of the statutory and consolidated financial statements, also based on a favourable proposal of the Board of Statutory Auditors, and also approved the engagement the fees for years 2008–2016.

Officer responsible for preparing the company accounting documents

Taking into account the provisions of the bylaws, the appointment of the Responsible Officer expired when the shareholders' meeting approved the financial statements for the year ended 31 December 2007.

In its meeting on 29 April 2008, the Board of Directors, with the favourable opinion of the Board of Statutory Auditors, confirmed Claudio De Conto, General Manager Operations of the Company, to whom all the administrative and tax structures of the Group report, as the Responsible Officer. The Responsible Officer's position expires when the term of the Board of Directors that has appointed him expires (approval of the 2010 financial statements). The Responsible Officer has been given all the organisational and management powers required to perform the tasks attributed by the current regulations, the Company bylaws and the Board of Directors. The Responsible Officer is granted full economic autonomy to exercise the powers attributed to him.

BOARD OF STATUTORY AUDITORS

The shareholders' meeting of 29 April 2008 integrated the Board of Statutory Auditors after the resignation of Paolo Francesco Lazzati with effect from the approval of the financial statements ended 31 December 2007 by the shareholders' meeting. With the procedures and within the terms specified in the Company bylaws, and conforming to the Self Regulatory Code of the Italian stock exchange, the shareholders' meeting appointed Paolo Domenico Sfameni as a Statutory Auditor. The Curriculum Vitae of the newly appointed Statutory Auditor is, as is the practice, available in the *Governance* section of the company website www.pirelli.com.

The current composition of the Board of Directors is, in addition to the usual report at the start of the publication containing this Half-yearly Corporate Governance report, also available in the *Governance* section of the Company website www.pirelli.com.

RELATIONS WITH SHAREHOLDERS

In line with its tradition of transparency and fairness, the Company actively promotes relations with shareholders, institutional and private investors and financial analysts, with other market operators and with the financial community in general, within the proper limits of their respective roles, and periodically organizes meetings both in Italy and abroad. To this end, with the further market development since March 1999 the company established an Investor Relations Department, which reports directly to the General Manager and Chief Operating Officer, Alberto Borgia, to foster relations with the financial community. This department has its own section on the company website at www.pirelli.com.

In the *Investor Relations* section, investors can find every document of interest published by the Company, related to financial reporting (e.g. the annual financial statements and the Half-yearly and quarterly reports) and the corporate governance system of the Company (e.g., the bylaws, the regulations for Shareholders' meetings, the Rules of conduct for transactions with related parties, the procedure for information flows to Directors and Auditors, the procedure for the management and communication to the public of sensitive information and the minutes of Shareholders' Meetings) in English as well as in Italian. The section also gives access to press releases issued by the Company and the documentation that the Company makes available to the financial community during presentations and/or meetings, as well as information on the composition of the share capital of the Company and shareholders (including the publication of any shareholders' agreements).

Pirelli & C. S.p.A. was one of the first companies in Italy and Europe to publish specific inserts giving economic and financial data in the mass media, as well as one of the first to set up a kit on its website for small investors.

Investor queries may be sent to: e-mail: ir@pirelli.com; tel: +39 02.64422949; fax: +39 02.64424686.

The Board of Directors

Milan, August 5, 2008