

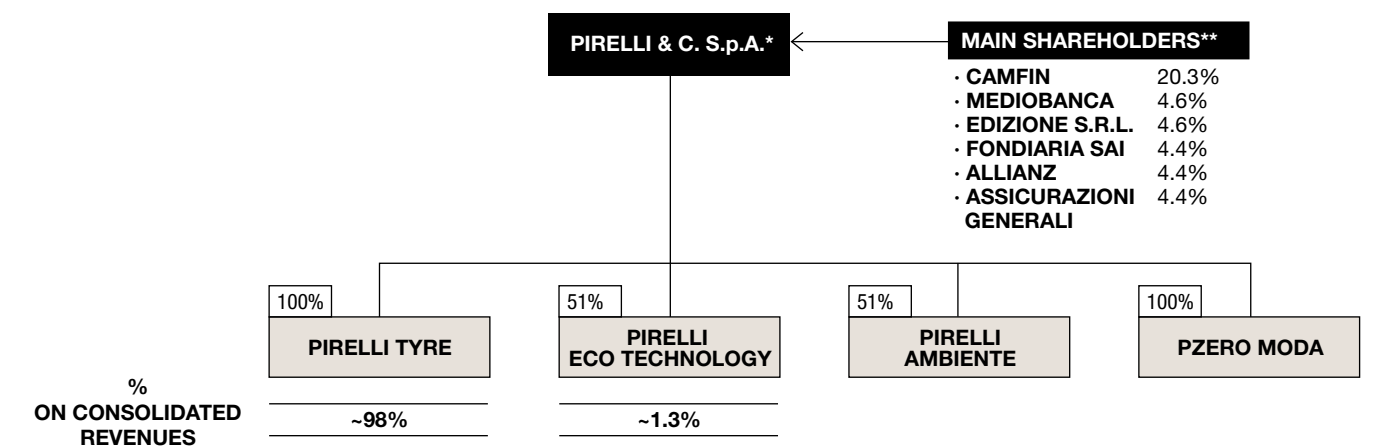
PIRELLI AND THE CREATION OF SUSTAINABLE VALUE

The adopted approach allows the creation of sustainable value over time, from which the company derives both tangible and intangible benefits

The world's fifth biggest tyre maker as measured by its turnover, the Pirelli Group is a leader in the high-end and high technology content segments. In business for over 140 years (having been founded in Milan in 1872), Pirelli now operates in 20 industrial areas on four continents and sells its products in over 160 countries. It boasts a long industrial tradition, which has always been based on innovation, product quality and a strong brand. That strength has been supported since 2002 by the PZero fashion and high tech project and has just been further reinforced by Pirelli's recent designation

as exclusive supplier to Formula 1 for the three-year period 2011-2013. While it has always been focused on research and development, Pirelli also implements a green performance strategy that dedicates constant, increasing attention to high quality, low environmental impact products, services and technology. Group efforts in these areas are supported by the activities of Pirelli Ambiente, which operates in the energy and environmental segments, and Pirelli Eco Technology, which focuses on emission control technologies.

PIRELLI CORPORATE STRUCTURE AS AT 31/12/2010



(*) The individual businesses rely on the support of Pirelli Labs (100% Pirelli & C.), the Pirelli centre for technological excellence and driver of innovation.

(**) The indicated percentages of investment represent only the portion granted to the "Shareholders' Agreement" at December 31, 2010. Camfin has announced that it directly or indirectly owned another 5.9% of the ordinary capital of Pirelli & C. Spa.

The process of transforming the Pirelli Group into a **pure tyre company** was completed in 2010. This transformation was undertaken in accordance with the 2009-2011 Business Plan and completed in 2010 with the **spin-off of Pirelli & C. Real Estate and disposal of non-strategic assets, including Pirelli Broadband Solutions and Oclaro** (formerly Avanex). Conclusion of this process, together with **realisation of the 2011 targets a year earlier** than scheduled in the 2009-2011 Business Plan, resulted in the **new business plan for 2011-2013 with vision to 2015**. That new plan was presented on November 4, 2010 and is extensively discussed in this report.

Pirelli Group **research and development** activities are key to the pursuit of its growth strategy, which not only allows continuous product and process innovation but also assessment of new business opportunities.

Group R&D costs totalled **Euro 146 million in 2010**, with a **3.1% ratio to sales**. Research and development activities are mainly concentrated in Pirelli Tyre, within which the Group has a research centre in Italy and eight application centres worldwide, and is staffed by over 1,000 employees – 60% of whom are from countries other than Italy.

The value of investments in research activity is expected to remain **at about 3% of sales over the next three years**, one of the **highest levels in the industry**. All of these factors will help lift the **number of patents** held by the Group (currently **over 4,500**), guarantee its ability to reduce the time needed to **update its line of premium products** approved as original equipment to less than four years, and **fully eliminate highly aromatic oils from its entire tyre line worldwide by 2013**.

SALES BY GEOGRAPHICAL AREA

Net sales in 2010 totalled Euro 4,848.4 million, up 19.1% from Euro 4,067.5 million in 2009. The percentage

breakdown of activities shows that 98.4% of sales were generated by the tyre business (98.1% in 2009). The following table shows the geographical breakdown of Group sales over the last three years:

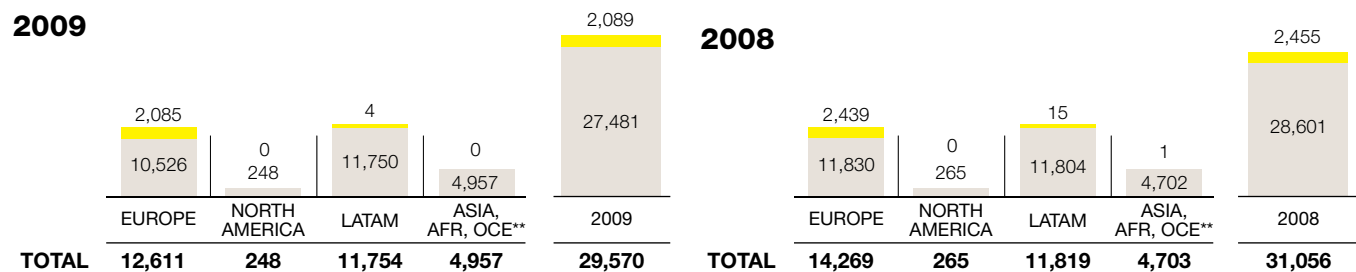
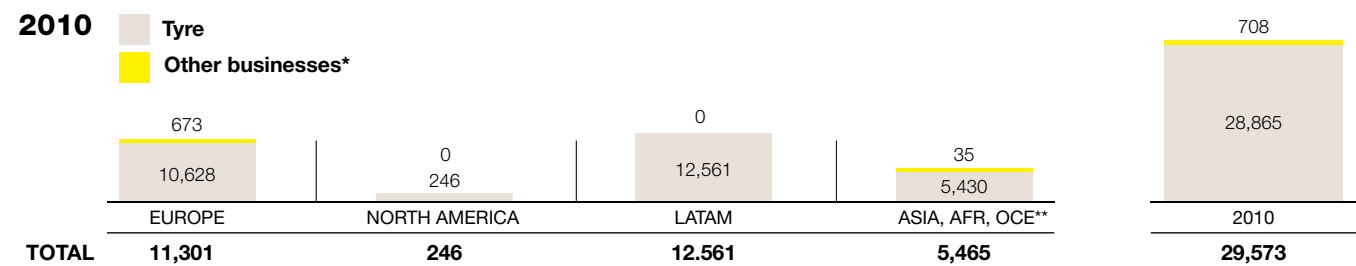
Sales* (in thousands of Euro)	2010	%	2009	%	2008	%
Europe:						
- Italy	485,450	10.00%	443,103	10.89%	447,766	10.74%
- Rest of Europe	1,503,531	31.00%	1,326,326	32.60%	1,457,669	34.95%
NAFTA	477,394	9.85%	361,454	8.89%	332,009	7.96%
Central and South America	1,632,044	33.66%	1,296,285	31.87%	1,279,444	30.69%
Asia/Pacific	286,922	5.93%	231,237	5.69%	648,020	15.54%
Middle East/Africa	463,077	9.55%	409,056	10.06%	4,243	0.10%
TOTAL	4,848,418	100.00%	4,067,461	100.00%	4,169,151	100.00%

(*) Net sales in 2010 do not include the operations discontinued during the year that belonged to Pirelli & C. Real Estate S.p.A. (now Prelios S.p.A.) and Broadband Solutions S.p.A. The previous periods (2009 and 2008) were consequently restated on a comparable basis.

The headcount at December 31, 2010 was 29,573 (29,570 in 2009 and 31,056 in 2008). It reflects the dis-

tribution of production activity at plants located on four continents, as illustrated in the following table:

GEOGRAPHICAL DISTRIBUTION OF EMPLOYEES

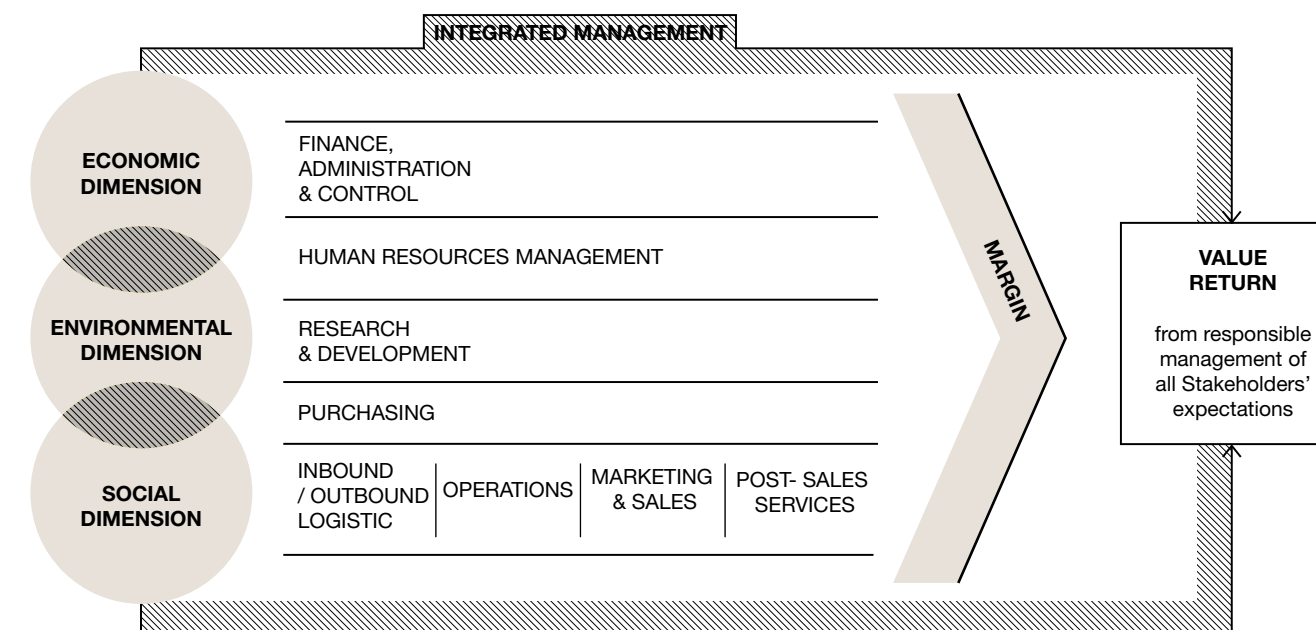


(*) includes Corporate, P.Ambiente, P.Zero, P.Eco Technology; for 2008 and 2009 it also includes the Real Estate and Broadband Solutions businesses that were discontinued in 2010, whose employees were no longer on the Group payroll at December 31, 2010.
 (**) Includes Turkey

For a complete snapshot of Pirelli operating performance in 2010, please see Volume 1 (Annual Financial Report at december 31, 2010).

STRATEGIC MODEL FOR SUSTAINABLE GROWTH

PIRELLI OPERATING APPROACH TO GENERATION OF SUSTAINABLE VALUE



As shown in the info graphic above, responsible management at Pirelli flows through the entire value chain. Every operating unit has economic, social and environmental responsibility for its own activity, while cooperating constantly with the other units and stakeholders, in implementation of Group strategic guidelines. The adopted approach makes it possible to create sustainable value over time, from which the company benefits from a tangible and intangible return on value.

- to business;
- competitors, because a competitive but fair competition generates improved customer services as well as market qualification;
- the environment, institutions, governmental and non-governmental bodies, and the communities around the world where the Group has permanent operations, through the awareness of its own global responsibilities as a corporate global citizen.

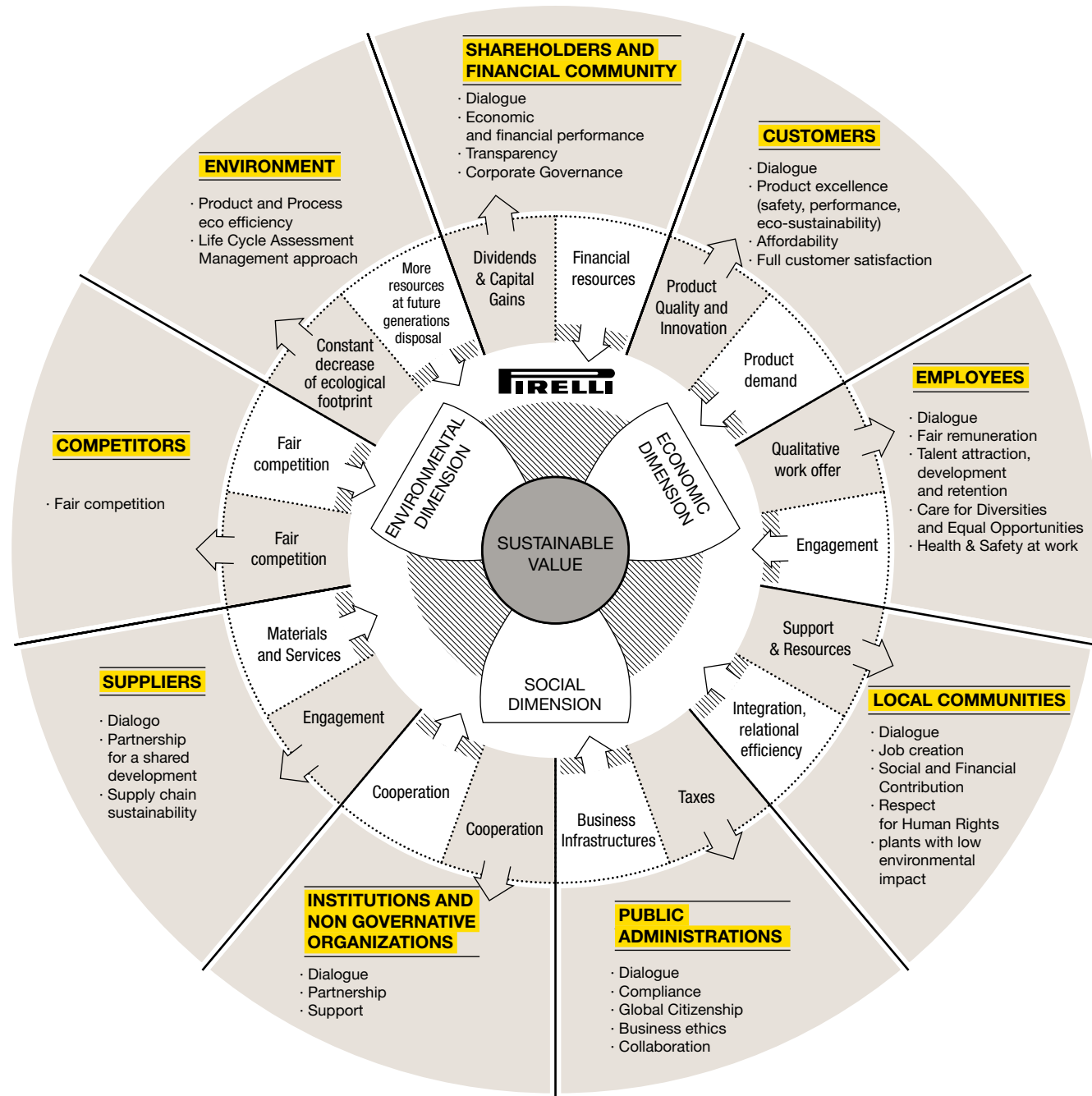
STAKEHOLDER ENGAGEMENT

- More than ever, Pirelli is absolutely convinced that its business is inextricably linked to its capacity to create value while satisfying the expectations of all its stakeholders:
- shareholders, investors and the financial community;
 - customers, since our way of doing business is based on customer satisfaction;
 - employees, who are the repository of Group know-how and drive its development;
 - suppliers, with which sharing a responsible approach

The Pirelli identity is historically based on a plurality of values that have always been pursued and protected. Pirelli Group adopts a multi-stakeholder approach, which means that it pursues lasting and sustainable growth based as far as possible on the equitable reconciliation of the interests and expectations of all those who interact with the company.

The following graphic illustrates the principal areas of value creation and return linked to the specific stakeholders:

PIRELLI STAKEHOLDER ENGAGEMENT MODEL: MAXIMIZATION OF THE VALUE FLOW FROM THE COMPANY TO STAKEHOLDERS AND VICEVERSA



SUSTAINABILITY IN THE ORGANISATIONAL STRUCTURE

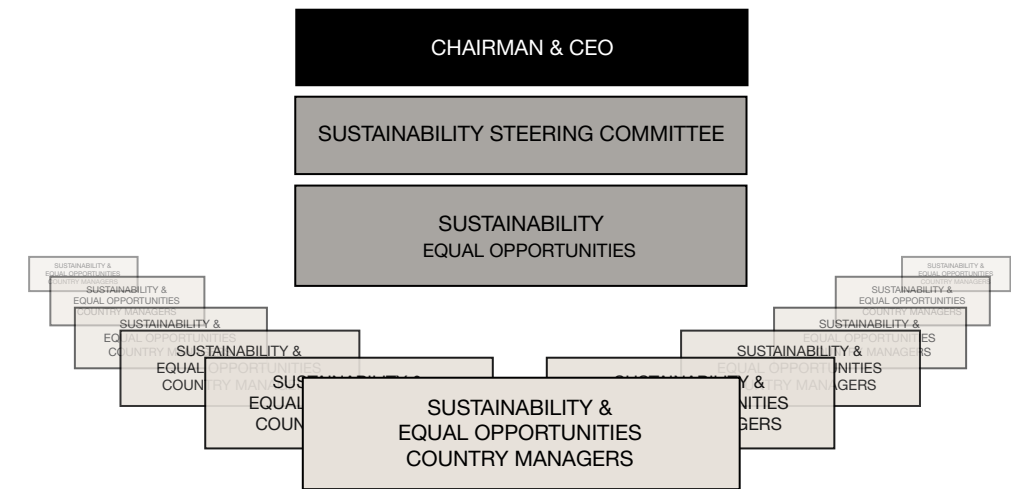
An advanced sustainability governance system allows the Group to effectively manage the economic, social and environmental impact of its processes, products and

services, with a constant focus on innovation, with the awareness of the role of a multinational group in a global context and in view of comprehensive risk prevention. The organisational basis of this governance is represented by the **Sustainability Steering Committee**, which is also responsible for **equal opportunity** issues and policy. This body, which was formed by the Chairman at the beginning of 2004 and chaired personally by him, is re-

sponsible for **setting policy and guiding the advancement of sustainability** throughout the company. Then, the organisational structure is made up of a **Group Sustainability and Risk Governance Department**, which reports directly to the **Group General Counsel**.

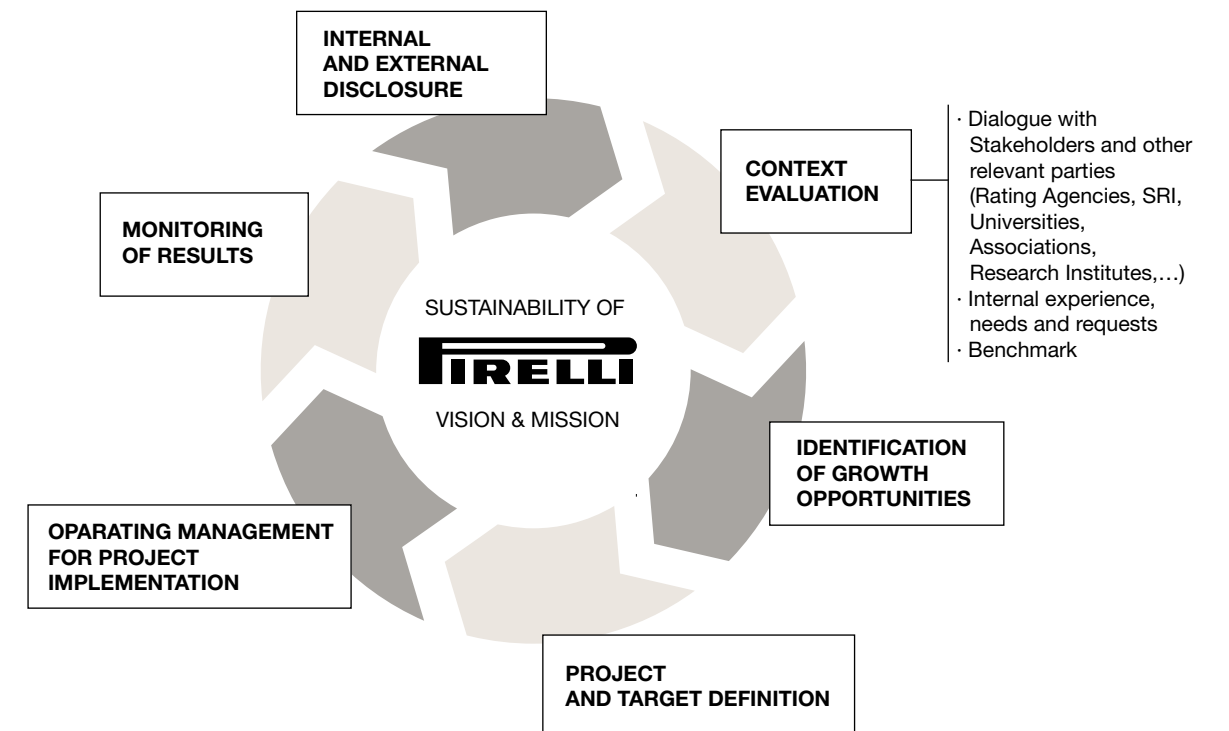
The SRG Department is centrally comprised by the **Group Sustainability and Equal Opportunities Officer** and locally by the **Sustainability and Equal Opportunities Country Managers**, covering all Group affiliates.

SUSTAINABILITY ORGANISATIONAL STRUCTURE



OPERATING MODEL FOR SUSTAINABLE MANAGEMENT AND PLANNING

The info graphic illustrates the operating steps focused on continuous improvement of sustainable performance:



SUSTAINABLE GROWTH STRATEGY: THREE-YEAR PLAN AND VISION TO 2015

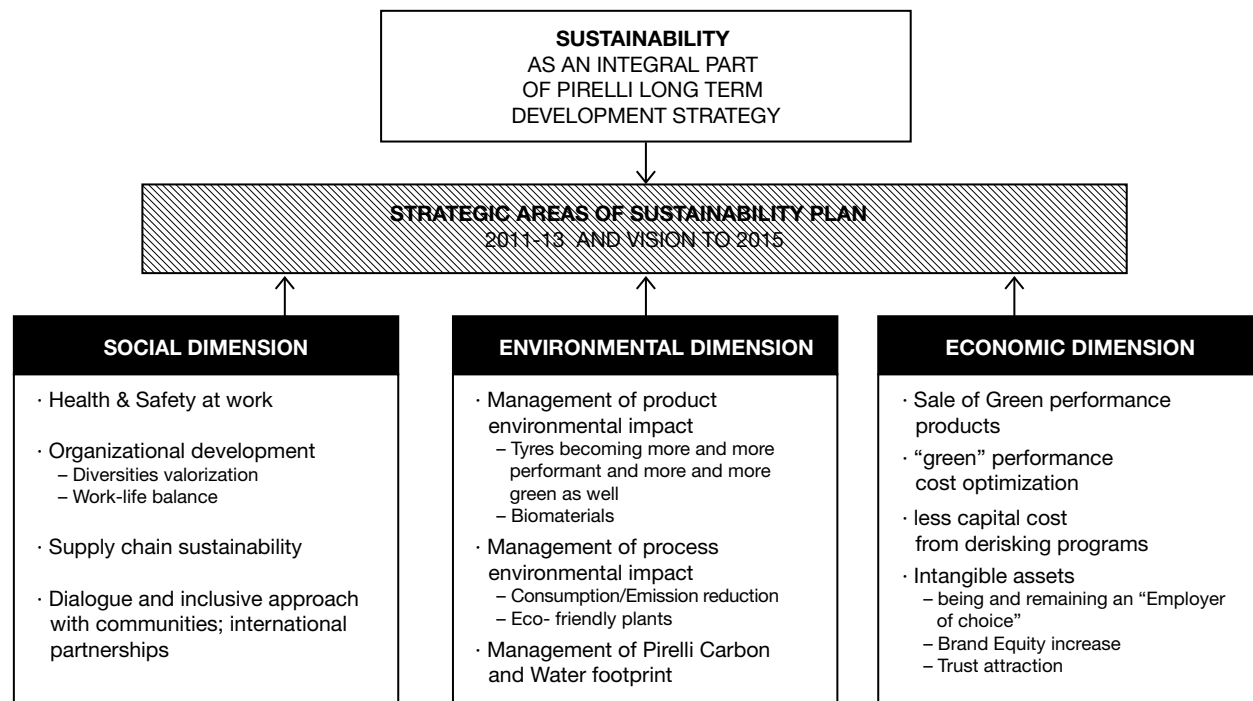
Pirelli presented the new **Group industrial plan for 2011-2013**, with **vision to 2015**, to the financial community in Milan on **November 4, 2010**.

Pirelli will invest Euro 1.9 billion over the **next five years**, increasing its production capacity and focusing on the **premium market** segment in rapidly developing economies. It will do so in accordance with the **local for local** strategy to improve product mix and efficiency and consolidate its **leadership** in all market

segments in Latin America.

As stated by the Chairman of Pirelli & C. S.p.A., Marco Tronchetti Provera, *"In a world that is changing fast and in which new areas of growth are emerging, we have developed a plan which puts the company in the best possible position to compete. In 2015, 60% of production will be in plants less than ten years old. These actions will allow us to offer products which are constantly being renewed, always more tailored to the specific needs of customers, with reduced environmental impact and greater competitiveness."*

An ambitious plan, of which sustainability strategies are a core element: on November 4, indeed, also the new Sustainability Plan for the years 2011-2013 with vision to 2015 was presented to the market.



Pirelli will use more and **more raw materials having a low environmental impact** in its production system, and it will use processes that will **reduce water consumption 35% and energy consumption 15% by 2015, with a 15% reduction in CO2 emissions from their 2009 levels**. The new **Settimo Torinese technological centre** will be fully operational by 2011, in support of Group energy policy. This new tyre plant aims at sustainable excellence in economic, social and environmental terms, will become the showcase of Group operations and technology, and will set the standard for other Pirelli production plants.

As far as **products** are concerned, Pirelli will continue pursuing its green performance strategy. It expects that

the percentage of **green performance products sales** will rise **from 37% of the total at the end of 2010 to more than 45% by the end of 2013**.

As regards **compounds**, Pirelli is actively developing and using a series of new, increasingly **ecological materials**. Research and development will enable the Group to **eliminate highly aromatic oils from its entire product line of tyres worldwide by 2013**.

Finally, as for **raw materials from renewable sources**, Pirelli has continued research activities leading to the production of **ecological silica derived from food processing scraps (rice husks)**.

In the area of **social responsibility**, existing workplace **health and safety** plans will be further improved through constant review of accident prevention and training programmes at company plants. **Human resources** policies will aim at improving management of **diversity**. **Audits** will continue to be conducted by independent outsourcers on **economic, social and environmental responsibility in the supply chain**. As regards the **relationships with local and international communities**, cooperation with governmental and non-governmental authorities will be reinforced to take joint initiatives targeting sustainable development.

Keen focus on the **quality of corporate governance** is key to sound and long-lasting development. In turn, corporate governance is based first and foremost on the central role played by the Board of Directors in defining strategic policy and supervising management, an effective risk management system and a top management remuneration policy that is closely linked to the creation of long-term value. The new system and analysis of risk factors, including opportunities, are an integral part of the strategic planning process. They allow undertaking recov-

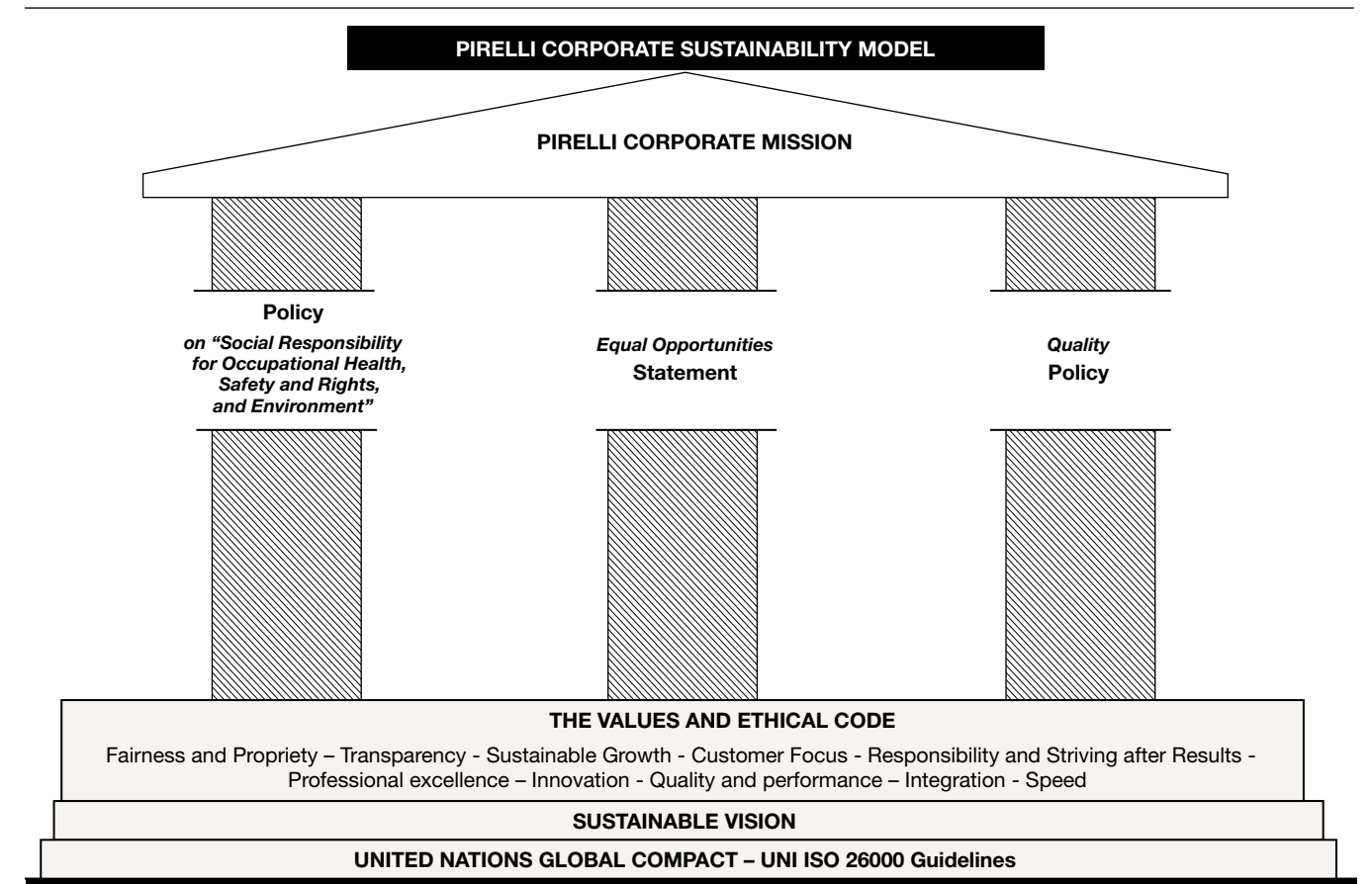
ery and mitigation plans, which transform **risk management into a value-creation driver**.

Major benefits are expected from **integration of the Business Plan and Sustainability Plan**, from the **intangible ones** of being an "employer of choice" and a company with growing brand equity, a reliable company for all stakeholders, to the **tangible ones** that are based on competitive advantage and sales of environmentally sustainable products, on cost improvements and on lower capital costs that can result from responsible, careful risk management.

SUSTAINABLE GOVERNANCE

For Pirelli, sustainable governance means integrating sustainability with the various aspects and ambits of company management. Thus, sustainability represents the adopted management model and translates into the mapping, control and sustainable management of all economic, social and environmental risks and opportunities connected with corporate activity.

THE PRINCIPLES UNDERLYING OUR SUSTAINABILITY SYSTEM



The **Pirelli Sustainability Model** is inspired by the **United Nations Global Compact**, of which Pirelli has been an active member since 2004 and by the recently issued **ISO 26000 guidelines**.

The compliance of the Pirelli Sustainability System with ISO 26000 Guidelines has been verified by third party, as stated in the Assurance Letter at the end of this report.

The resulting vision permeates the Group Sustainability documents: its **Values and Ethical Code**, its **Quality Policy**, its **Social Responsibility Policy for Occupational Health, Safety and Rights, and Environment**, and its **Equal Opportunities Statement**.

The adopted Model embraces the entire value chain to preserve and develop Group assets.

UNITED NATIONS GLOBAL COMPACT



In October 2004, in a letter addressed to the Secretary General, Kofi Annan, Pirelli Group formally declared its **adhesion to the United Nations Global Compact** and its **commitment** to observe and support its **Ten Principles** in the areas of human rights, labour standards, the environment and the fight against corruption.

The letter of adhesion to the Global Compact is published in the Sustainability section at www.pirelli.com.

THE VALUES AND ETHICAL CODE OF THE PIRELLI GROUP

The document outlines **Pirelli's sustainable approach to business, by imposing strict, uniform guidelines** for professional practices that everyone working for or with the company must obey.

Approved by the Board of Directors of Pirelli & C. S.p.A. in 2003, the Ethical Code was amended in 2009 to bring it in line with the evolution of the Group's sustainability strategy and to satisfy new market and corporate governance requirements. The amended version was then approved by the Board of Directors of Pirelli & C. S.p.A. Within the ambit of their own functions and responsibilities, the directors, statutory auditors, executives and employees of the Pirelli Group, as well as everyone else working on behalf or in favour of the Pirelli Group, or having business relationships with it (the "**Addressees of the Code**"), either inside or outside Italy, must comply with the principles and obligations set out in the Code. More specifically, the Code:

- illustrates the values on which Pirelli's own business activities are based, i.e. fidelity, fairness, transparency, sustainable growth, customer focus, responsibility

and results-oriented effort, professional excellence, innovation, quality and performance, integration and promptness;

- indicates the principles of conduct on which Pirelli bases its own business activity in internal and external relations;
- identifies the stakeholders with which Pirelli interacts, describing the sustainable approach that characterises their relationship with each one of them;
- envisages appropriate penalties for violation of the Code.

The Group's Whistleblowing procedure is a key tool for enforcing compliance with the Code, and is the subject of a special section elsewhere in this chapter.

The Values and Ethical Code and the *Whistleblowing Procedure* have been distributed to all Pirelli employees in local language versions.

Suppliers too are formally required to comply with the values and business approach set out in the Code. This is why the document has been published in the sustainability section of the Pirelli institutional website not only in the languages spoken by its employees but also in those that are most representative of the panel of suppliers.

PIRELLI GROUP POLICY ON SOCIAL RESPONSIBILITY FOR OCCUPATIONAL HEALTH, SAFETY AND RIGHTS, AND ENVIRONMENT

The Policy affirms Pirelli's formal acceptance of the *Universal Declaration of Human Rights*, the *International Labour Organisation Declaration on Fundamental Principles and Rights at Work*, the *Rio Declaration on Environment and Development* and the *United Nations Convention against Corruption*, from which the principles of the Global Compact are derived.

The commitments affirmed in the Policy are inspired by the cited documents, and thus the United Nations Global Compact – of which Pirelli has been an active member since 2004 – and the contents of the SA8000® international standard. The company officially adopted this standard in 2004 as the benchmark tool for management of social responsibility.

Suppliers are also formally required to comply with the principles and commitments stated in the Policy, just as they must comply with the Pirelli business approach and the values set out in the Ethical Code.

The Policy, which was issued in 2004 and officially revised by the Chairman in 2009, has been distributed to all employees in their local language. It has also been

published in the Sustainability section of the Pirelli institutional website, not only in the languages spoken by employees but also in those that are most representative of the panel of suppliers.

PIRELLI GROUP EQUAL OPPORTUNITIES STATEMENT

The Equal Opportunities Statement sets out the proactive approach taken by Pirelli to equal opportunities in the workplace and career development, while also clearly illustrating the Group's valorisation approach to management of diversity. It lists the commitments made by Pirelli in this area, as set out in *The Values and Ethical Code*, in *The Pirelli Group Policy on "Social Responsibility for Occupational Health, Safety and Rights, and Environment"* and – a priori – the United Nations Global Compact and the SA8000® Standard.

The Statement, which was issued by the Chairman in 2006, has been distributed to all employees in their local language and published in the Sustainability section of the Pirelli institutional website, available to the External Community.

For more details on the management of diversity and equal opportunities at the company, please see the section dedicated to these topics in the Social Dimension chapter of this report.

PIRELLI GROUP QUALITY POLICY

The *Quality Policy* reflects the full integration of sustainability in the Group's management strategy. Quality is a core value in Pirelli operations, pervading all of its functions and processes. Its scope of application ranges from continuous innovation of products, services, processes and systems to protection of the integrity, health and wellness of Group employees, environmental protection throughout the entire product life cycle, and strategic collaboration with suppliers.

"Corporate quality" essentially corresponds to a focus on the demands and interests of stakeholders, ethics, innovation, excellence and safety for sustainable competitiveness. Specific emphasis is given to employees involvement and the key role that they play in promoting a sustainable quality culture.

The Policy, which was officially revised by the Chairman in 2009, has been distributed to all employees in their local language. It has also been published in the *Sustainability* section of the Pirelli institutional website, not only in the languages spoken by employees but also in those that are most representative of the panel of suppliers.

GOVERNANCE TOOLS FOR LONG-TERM DEVELOPMENT

CORPORATE GOVERNANCE

Pirelli has adopted a traditional management and control system. The key features of the Pirelli corporate governance system are: (i) the central role of the Board of Directors, in its capacity as the supreme body in charge of company management; (ii) the central role played by independent directors, who hold a majority of the seats on the Board of Directors; (iii) a consolidated policy of disclosing corporate decisions and the processes that led to their being taken, as well as an effective internal control system; (iv) an innovative system of pro-active risk management; (v) a management incentive system tied to medium and long-term goals; (vi) rigorous rules governing potential conflicts of interest and firm rules of conduct for related party transactions.

Pirelli & C. has adhered to the Corporate Governance Code of listed companies ever since it was first published by *Borsa Italiana* (Italian Stock Exchange). The company subsequently affirmed its adherence to the new March 2006 version of the Corporate Governance Code.

The other key features of the Pirelli governance system include:

- a high level of transparency, with descriptions of semi-annual updates and additions to the corporate governance system to reflect changes from what is illustrated in the Annual Report;
- membership on the Board of Directors of a large number of independent directors, holding more than 50% of Board seats and representing about 90% of all non-executive directors;
- the important role given to non-controlling interests, who elect 20% of the Board of Directors when lists are submitted (currently 4 out of 20);
- the establishment of Board committees comprised exclusively of independent directors;
- designation of a Lead Independent Director, who is assigned an active and effective role in coordinating the requests and contributions of independent directors;
- periodic meetings of the independent directors and work meetings of directors with top management in order to improve their familiarity with the company's actual operating conditions and facilitate their contribution to management, and to improve the effectiveness of their respective positions;
- the Board of Directors' consolidated practice of reviewing its own performance, with the aid of an expert consulting firm;
- a new system for management and governance of managerial risks;

- establishment of the Group Compliance department;
- the control resulting from the Group *Whistleblowing Procedure*.

Consistently with the provisions governing the traditional management and control system that has been adopted, the Board of Directors is in charge of managing the company. The Board plays a key role in its strategic guidance, as well as in supervision of all business activity, with the authority for overall management policy making and direct action in a series of decisions that are necessary or useful for pursuing the corporate purpose. The Board is responsible for taking key economic or strategic decisions or those having a structural impact on management, i.e. decisions supporting supervision of the Group and its policy. The Board of Directors relies on the support of its own internal committees to perform its duties. These standing committees are comprised of independent directors having investigative, policy making and/or consultative duties. The Board is also supported by managerial committees whose members are drawn from Group senior management to implement the directives and policies issued by the Board and delegated bodies.

Pursuant to the Bylaws, the Board of Directors has no less than seven and no more than twenty-three members, who serve for a term of three financial years (or a shorter term that might be set by the General Meeting when they are elected), and they may be re-elected. The Board of Directors in office at December 31, 2010 is comprised of 19 directors and was elected by the Shareholders' Meeting on April 29, 2008 for three financial years, expiring on the date of the General Meeting called to approve the annual report at December 31, 2010. Consequently, the next General Meeting called to approve the 2010 Annual Financial Report will elect a new Board of Directors. More information in this regard can be found in the Directors' Report to the General Meeting published on the company website. The Board of Directors is comprised of two directors with executive authority: the Chairman (who is also delegated specific duties) Marco Tronchetti Provera and the Deputy Chairman Alberto Pirelli, seven non-executive directors and ten independent directors (of whom X are elected by non-controlling interests).

For some time now, the absolute majority of seats on the Board of Directors have been held by independent directors.

The Board of Directors defines the independence of its directors on the basis of their not having relations with the company and/or with its principal shareholders and managers that might influence their judgement. When it evaluated their independence, the Board of Directors referred to the requirements recommended by the Corporate Governance Code issued by Borsa Italiana, which the company has adopted. For a more detailed description of the requirements necessary for determining the

independence of directors, reference is made to the *Report on Corporate Governance and Shareholdings*.

In **advance** of the deadlines (which will come into force next year) mandated in the Corporate Governance Code and even more recently in the Consolidated Law on Finance, the company has decided to adopt a **General Remuneration Policy**, to be submitted to shareholders for a vote at the next General Meeting. The Policy contains guidelines for defining the compensation of executive directors and management in general, aimed at attracting, motivating and keeping the human resources who have the professional qualifications for profitably pursuing Group objectives.

The Policy is defined in such a way as to align management interests with those of shareholders, with the primary objective of creating sustainable value over the medium/long-term through a strong link between compensation, on the one hand, and individual and Group performance on the other.

Definition of the Policy is the result of a clear and transparent process in which the Remuneration Committee and the Board of Directors play a key role.

The Policy was approved by the Board of Directors at its meeting on March 8, 2011 and submitted to the General Meeting for approval of the 2010 Annual Report. As previously mentioned, it defines the following principles and guidelines:

- (i) the Board of Directors defines the remuneration:
 - of the members of the Board of Directors and, in particular, the directors delegated with specific duties;
 - of the general managers;
 - of the executives with strategic responsibility;
- (ii) the Group defines the remuneration of senior managers and Group executives in general.

For a more detailed description, please see the *General Remuneration Policy* found at the end of the Report on Corporate Governance and Share Ownership, Volume 2. For further details on the corporate governance system, reference is made to Volume 2 as well. The section dedicated to the company's corporate governance system can also be accessed through the homepage of the website www.pirelli.com.

RISK GOVERNANCE SYSTEM

The current macroeconomic situation, financial market volatility, complex management processes and continuous legislative and regulatory evolution force successful businesses to renew their ability to protect and maximise tangible and intangible sources of value that characterise their own business model. Assessing and preventing risks that might compromise the Group's values and objectives have always been an integral part of Pirelli's distinctive

Risk Management office is independent of business and Internal Audit

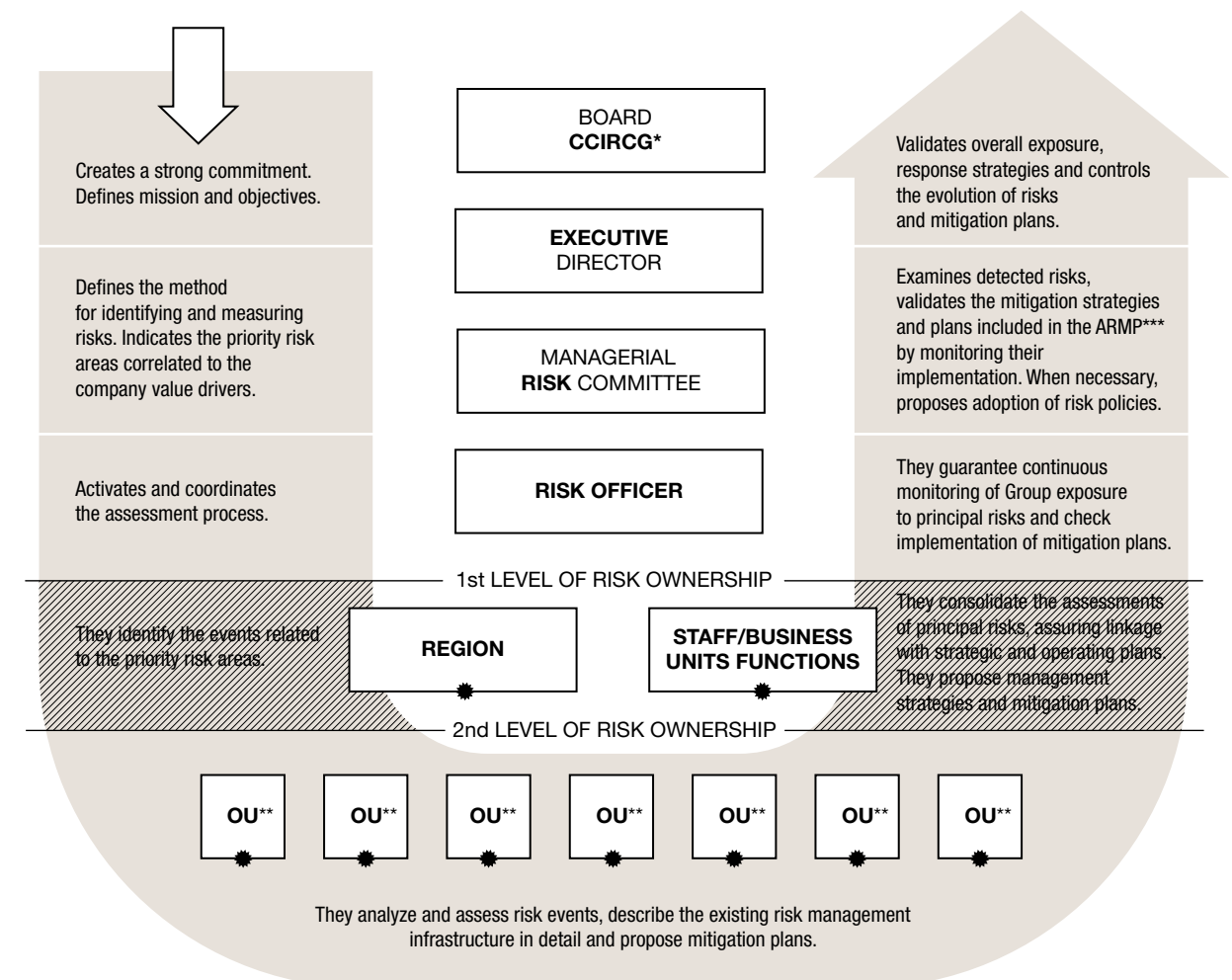
spirit of innovation and professional excellence. For these reasons, the Board of Directors decided in 2009 to upgrade its corporate governance system by introducing a pro-active risk management system. It uses a systematic and organised process of identifying, analysing and assessing risk-prone areas that could compromise the attainment of strategic objectives, provides the Board of Directors and top management with decision-making tools so that they can anticipate and manage the effects of these risks and, more in general, "govern" them. **Strategic objectives are not only economic but also social and environmental, reflecting full integration of the sustainability system in corporate development plans.**

The chosen Model is based on a precise **methodological approach** that is: (i) **value driven**, insofar as the most significant risks are identified according to their capacity to prejudice attainment of the Group targets defined in the Strategic Plan, or impair "critical" corporate assets ("**Key Value Drivers**"); (ii) **top-down**, insofar as top management takes the lead in identifying priority risk areas and events having the greatest impact on the business; (iii) **quantitative**, i.e. based on exact measurement of the impact of risks on forecast operating and financial results.

The risk management system is illustrated as follows:

Focus on key value drivers, over and above processes

Central role played by the board of directors and top management



(*) Internal Control, Risks and Corporate Governance Committee | (**) Operating Units | (***) Annual Risk Management Plan | ● Risk Owner

For more information about the Pirelli risk governance system, please see 2010 Corporate Governance Report, Volume 2 (Report on Corporate Governance and Share Ownership).

RISKS AND UNCERTAINTIES

The principal areas of risk to which the company might be exposed are illustrated in detail in the section *Risks and uncertainties* within the Directors' report on Operations in Volume 1, to which the reader is referred for detailed discussion of these issues.

A summary of these risks and uncertainties is provided as follows:

- **Strategic risks**, which are closely tied to Pirelli's objectives and consequent strategic choices. This category includes the exogenous risks stemming from evolution in the external context where the Group operates and the risks stemming from internal factors, such as financial risks, the risks connected with typical business processes and human resource/organisation risks.

The most significant risk factors in this area include increased competition in the markets where Pirelli operates, especially Europe and Latin America, and the steady rise in raw material costs (especially natural rubber). These factors might partially impair overall profitability, to the extent that the Group is unable to modify the commercial price/mix component and the internal cost efficiency component.

The Pirelli Group operates in countries such as Venezuela, Argentina, Brazil, Turkey, China, Egypt, where the general political and economic context and tax systems might prove unstable in future.

- **General risks**: regardless of implemented strategies, Group operating activities rely increasingly on the proper, uninterrupted functioning of information systems and network infrastructure in support of business processes. The complexity of the information system environment used, the distribution of activities worldwide and links between them may increase the level of risks connected with information and communication technology. The global scale of Group operations exposes it to a plethora of risks (stemming from natural events, malicious acts, malfunction of auxiliary plants or interruption in the supply of utilities) that might even cause an interruption in business activities for an indefinite period of time, consequently impacting its operating and financial results. In 2010 the assessment of ten infor-

mation systems critical to the Group and of five production sites was completed. Risk mitigation activities were undertaken on the ten information systems and operating continuation plans were prepared for the production sites.

THIRD PARTY AUDITS ON SOCIAL AND ENVIRONMENTAL RESPONSIBILITY

Risk management at Pirelli is comprehensive and includes the identification, analysis and monitoring of environmental, social and financial risks that are not only directly associated with the company but also connected with the sustainability of the supply chain.

Together with constant co-ordination and monitoring at the corporate level, compliance with Pirelli **economic, social** (especially human rights and labour rights) **and environmental sustainability** rules is constantly assessed in periodic audits commissioned from **specialised independent firms**. Special attention is dedicated to the sustainability of Pirelli and supplier sites in "countries of concern" (as defined by EIRIS).

As early as 2008 **independent audits were carried out at Pirelli production plants and commercial locations** in Turkey, Brazil, Venezuela, Argentina, Egypt, China, Romania, Colombia, Mexico and Chile (commercial offices only are located in the last three countries) to monitor internal compliance with the **SA8000® Standard** (the benchmark tool used by the Group to manage social responsibility).

In 2011 Pirelli will commission **new, independent SA8000® audits** of production sites located in South America, China, Egypt, Turkey and Romania.

Between the end of 2009 and the beginning of 2010, independent audits were carried out on the chain of suppliers operating in countries of concern, involving a total of **72 suppliers**.

Another **58 audits of suppliers** were conducted between the **end of 2010 and early 2011** in the United Kingdom, Germany, Italy, China, India, Latin America, Turkey, Egypt and Romania.

For more information about these audits, please see the "Suppliers" dedicated section in the economic dimension of this report.

Ad hoc assessments are also carried out before entering a specific market, in order to assess any political, financial, environmental and social risks, including those connected with respect of human and labour rights.

COMPLIANCE

The Group Compliance Office – under the supervision of the General Counsel, Corporate Affairs and Group Compliance Department – interacts with **all** corporate departments to ensure that internal rules, processes and corporate activities **constantly comply** with the applicable regulatory framework and Ethical Code.

The Group Compliance Office actively participates in identifying the risks of non-compliance with internal and external rules, thereby playing a key role in preventing judicial and administrative penalties or major financial losses, including damage to reputation.

The principal projects implemented in 2010 by the Group Compliance Office include:

- the revision of the "231" Compliance Programmes, adopted by the Group in accordance with the spirit that characterises Pirelli, for continuous reinforcement of its own corporate governance and, in particular, its internal control system mechanisms, including in consequence of the new "presumed offences," the liability of companies for offences committed by their employees and/or collaborators that have recently been enacted by lawmakers. All employees were notified of the launch of the project through the company intranet. Furthermore, the following individuals at the Group received personal notice of the launch of the project: executives of Italian companies, officers of Italian companies, middle managers of Italian companies and expatriate employees of Italian companies working abroad;
- methodological support under Law 262/05 for the "Corporate Financial Reporting Manager" and assistance for Group companies to ensure that corporate activities are operated in compliance with Law 262/05;
- In 2010, the Code of Conduct appended to the "231" Compliance Programmes and applicable to all Group companies were also revised and amended. The Code of Conduct set out the operating application of the principles of the Ethical Code and introduce specific rules to avoid the establishment of environmental situations favourable to the commission of offences in general and acts of corruption and administrative offences in particular as envisaged in Legislative Decree 231/2001. The Guidelines will be distributed to all employees in their local language in 2011. Specific training activities will also be planned during the year.

In regard to **corruption and related offences**, as set out in the Ethical Code and in the Code of Conduct, Pirelli has a clearly stated position of not tolerating "corruption in any guise or form, or in any jurisdiction, or even in places where such activity is admissible in practice, tolerated, or not challenged in the courts. For this reason," the Code continues,

"Addressees of the Code are prohibited from offering complementary gifts or other benefits that could constitute a breach of rules, or are in conflict with the Code, or might, if brought to public notice, damage the Pirelli Group or just its reputation."

The Code also states that Pirelli

- *"defends and protects its corporate assets, and shall procure the means for preventing acts of embezzlement, theft, and fraud against the Group";*
- *"condemns the pursuit of personal interest and/or that of third parties to the detriment of social interests."*

The *Whistleblowing Procedure*, described in the following section, is a tool used for enforcing compliance with Group rules.

In turn, the **Internal Control System** relies on an integrated process of identification, measurement, management and monitoring of major risks, monitors the efficacy and efficacy of business operations, while guaranteeing that documents and decisions are traceable; the reliability of accounting and operating information; compliance with laws and regulations; the protection of company assets.

GROUP WHISTLEBLOWING PROCEDURE

A key tool used to enforce compliance and internal control, as well as prevent risks, is represented by the Group *Whistleblowing Procedure*. This procedure has been established to handle reports of possible cases of corruption or violation of the principles and/or precepts set out in the *Ethical Code* – including equal opportunities – statutes and regulations.

The *Whistleblowing Procedure*, which has been distributed to all employees in their local languages, spells out how to report violations, suspected violations and inducement to commit violations of laws and regulations, the principles set out in the *Ethical Code*, internal control principles, corporate rules and procedures, or any other acts or omissions that might cause direct or indirect financial damage or harm to the image of the Group and/or its subsidiaries.

The Procedure explicitly **encourages** employees who are aware of potential or actual violations to report them immediately to the company, **either anonymously or openly**. They are guaranteed **absolute confidentiality** and **protection from reprisals of any sort**.

These reports may involve company directors, statutory auditors, management and employees, as well as anyone else who operates inside or outside Italy on behalf of the Pirelli Group or has business relationships with the

Group. This includes partners, customers, suppliers, consultants, independent contractors, accounting firms, and public institutions and entities.

The e-mail box and telephone and fax numbers, provided to those who want to file a report, are managed at the corporate level by the **independent Internal Audit Department** and are to be used by all Group affiliates.

The **Pirelli Internal Audit Department** is responsible for:

- setting up, managing and updated the addresses for sending communications; receiving, registering and analysing the received reports by engaging the participation of other corporate departments and offices for investigation as necessary and forwarding any reports to the supervisory bodies with jurisdiction according to the situations where a specific supervisory body exists (for Italian companies: the Board of Statutory Auditors, the Supervisory Bodies for offences pursuant to Legislative Decree 231/01);
- preparing specific action plans;
- ensuring the retrieval and storage of documentation for five years after the conclusion of the investigation;
- filing a quarterly report with the Internal Control Committee of Pirelli & C S.p.A. on reports received and actions underway.

If it is ascertained that the report is valid, the company must take appropriate disciplinary measures and legal action to protect itself and the Group, if necessary.

In 2010, the *Whistleblowing Procedure* was activated **just once**, following an anonymous report of presumed conduct in violation of company rules and procedures, particularly in regard to the internal rules that govern fair, transparent purchasing processes.

The analyses carried out by the Group Internal Audit Department did not reveal conduct confirming the allegations made in that anonymous report.

STOCK MARKET INDICES AND ETHICAL FINANCE

The commitment to create long-term value that characterises the company's responsible management and economic, social and environmental performance, has led to Pirelli being ranked on some of the world's most prestigious stock market sustainability indices.

Pirelli is strongly represented in the portfolios of socially responsible investors, especially in Europe and North America. A tailored communication strategy is dedicated to this area, and promoted through specific roadshows. The assessments of company performance by SRI ana-

lysts and investors create benchmarking opportunities and offer ideas for continuous improvement.

In June 2010, Pirelli sponsored the seminar "Business Sustainability and Responsible Investments for the Creation of Long-term Value," organised by the Academy-London Exchange Group and held at the headquarters of *Borsa Italiana*. On that occasion, the Chairman emphasised the importance of integrating the sustainable business model in strategies for growth and to maintain long-term value. The speakers at the event included Paul Druckman, Chairman of Access Technology Group – The Prince's Accounting for Sustainability Project, and Giuseppe Van Der Helm, Chairman of Eurosif.

The following ethical finance indices on which Pirelli appears are illustrated below:

DOW JONES SUSTAINABILITY INDICES



Pirelli has been included in the Dow Jones Sustainability indices since 2002.

For the fourth year in a row, Pirelli was confirmed as **global sustainability leader in the Autoparts & Tires** sector in September 2010, as part of the Dow Jones Sustainability World and Europe indices. **For the second year in a row**, Pirelli is also **the only Italian company to be ranked as a world leader in its own sector**. Pirelli's overall **rating for 2010 was 90%** (+2% from 2009), **compared with an industry average of 55%**.

The Dow Jones indices are revised every year by **SAM Group**, a Swiss asset manager responsible for assessment, admission or exclusion of companies from the Dow Jones sustainability equity indices.

In **January 2011** Pirelli was named **world sustainability leader** in the "Autoparts and Tyres" Sector and **Gold Class Company** for the fourth year in a row in the prestigious *Sustainability Yearbook 2010*, published by SAM Group in collaboration with PricewaterhouseCoopers.

The *Yearbook* is one of the most complete and authoritative global benchmarking tools for sustainable finance specialists. It includes only the top sustainability scoring companies, ranked as such by SAM Group in the Dow Jones Sustainability Assessment, or 15% of firms in 58 business sectors.

FTSE4GOOD INDICES



FTSE4Good

Pirelli's rating (expressed in qualitative terms in the profile prepared by **EIRIS** analysts) in 2010 showed further improvement from previous years.

In **March 2011**, for the first time, FTSE Group has given an **overall rating** to the 2,400 companies included on the list, **giving Pirelli a score of 97 on a scale from 1 to 100** in the Automobiles & Parts sector.

The benchmark is comprised of the FTSE All-share Index and FTSE Developed Europe Index, excluding tobacco and weapons makers, owners or operators of nuclear power plants, and uranium mining or production companies.

Pirelli has been included in the FTSE Global and European STOXX indices since 2002.

ASPI EUROZONE® INDEX



Pirelli has been included since the beginning of 2005 in the **ASPI EUROZONE®**

(**Advanced Sustainable Performance Indices**) index, which includes the 120 best-performing companies in terms of sustainability on the basis of ratings issued by **Vigeo**, a social and environmental rating agency. The ASPI survey pool is comprised by the companies included in the DJ EURO STOXX index. The 120 companies with the best sustainability performance are ranked on the ASPI EUROZONE® index.

The assessment of Pirelli conducted in 2010 showed **further improvement** from the previous years, particularly in the areas of **corporate governance** and **human rights**.

AXIA INDICES



Pirelli has been included in the **Axia Ethical Index** since 2004 (the year when the index was created) and in the **Axia Csr Index** since 2005 (the year it was created). Pirelli is also included in the **Axia Euro Ethical Index** and **Axia Euro Csr Index**.

The Axia indices interact with the major international platforms for financial operators and encompass international best practices in corporate social responsibility for a range of companies selected from those with the highest capitalisation for the S&P MIB and Eurostoxx60 indices. **Pirelli has been awarded an A+++ rating for the fourth consecutive year**, while it was rated A++ until 2006: it has thus achieved the best score possible in terms of ethics.

EPCI INDICES



Pirelli has been included in the ECPI ethical finance indices since 2008.

In particular, Pirelli is included:

- in the **EMU Ethical Index**, which ranks the 150 largest companies by capitalisation in the EMU (Economic and Monetary Union) market;
- in the **FTSE ECPI Italia SRI Benchmark**, whose components, selected from the FTSE MIB and FTSE Italia Mid-Cap baskets, are distinguished by their good rating in environmental, social and governance (ESG) terms;
- in the **FTSE ECPI Italia SRI Leaders index**, whose members, selected from the FTSE MIB and FTSE Italia Mid-Cap baskets, are qualified as excellent in terms of environmental, social and governance (ESG) sustainability;
- in the **investment universe** of companies listed on the **ECPI Ethical Index Global** and **ECPI Ethical Index Euro**.

The ECPI Italia SRI Benchmark and FTSE ECPI Italia SRI Leaders indices were launched on September 19, 2010 by ECPI and FTSE Group. They represent the first series of indices on the Italian market for responsible investment.

Pirelli has an **EE+ rating**, corresponding to the profile of firms that have a transparent long-term strategic outlook, good operating management and make a positive contribution to society and the environment.

ETHIBEL EXCELLENCE INVESTMENT REGISTER



Pirelli has been included in the **Ethibel EXCELLENCE** Investment Register since 2008.

Forum Ethibel, an independent association that bases its research on reports prepared by Vigeo, the social and environmental rating agency, assesses the sustainability profile of companies for their inclusion on the Ethibel Register.

KEMPEN INDICES



Pirelli has held **Pass Status** since 2003 in the entire Kempen Capital Management "**KEMPEN SNS Socially Responsible Investing Universe**," with continually improving ratings.

The investing universe includes companies listed in Europe that prove they have adopted the highest standards in terms of ethical, environmental, and human resource standards and reporting.

PRINCIPAL AWARDS RECEIVED DURING THE YEAR

Pirelli received numerous awards in 2010 for its sustainable performance accomplishments, both in terms of product and the quality of relations with stakeholders. Some of the awards it has received are listed below in reverse chronological order, from January 2011 to January 2010.

JANUARY 2011

- In China, at the **Guangzhou Auto Show**, the magazine **Auto news** ranked the **Pirelli Cinturato P7** tyre as “**The best balanced tyre of the year.**” The **Cinturato P7** stood out for its road hold, stability, tread pattern optimised to reduce its noise level and the low-carbon emissions production process.
- In England, Pirelli was ranked as the **Most Recommended Tyre Brand for 2010**, according to the market survey conducted by **Encircle Marketing**.
- Pirelli won the first edition of the **Lundquist Employer Branding Online Awards Italy 100**, qualifying as number one in Italy in online communication of employer branding, i.e. the company’s appeal as employer on the basis of the transparent, clear and concise communication through which it seeks to attract job applicants. The analysis considers the principal components of online employer branding: **Proposition** (how the company presents itself and what it offers to employees), **Recruitment** (information for job candidates) and **User experience** (presentation of content).

NOVEMBER 2010

- The Shandong Provincial Government awarded **Pirelli China** the “**Qilu Friendship**” prize for its contribution to the economic and social development of that Chinese province.
- In Switzerland, Pirelli was proclaimed the best tyre brand of the year for the fifth year in a row, and it won the “**Best Tuning Cars & Best Brands 2010**” competition, the most popular contest amongst readers of **Auto Illustrierte** (AI), a prestigious independent car magazine.
- In Germany, Pirelli has been ranked as the “**Best Brand 2010**” by the readers of **SportAuto** for the third consecutive year. This is the authoritative German magazine for automotive enthusiasts, who consider Pirelli to be the “most ‘sporty’ and ‘emotional’ brand.” Pirelli was especially appreciated in the sportsmanship category, for the score it achieved in the areas of “stability in curves,” “high-speed safety,” “excellent braking performance” and “emotionality.”

OCTOBER

- In Germany, Pirelli was proclaimed “**Top automotive employer 2010/2011**” by CFR, the national research institute that provides comparative analyses on HR management and corporate best practices. Corporate culture, work-life balance, pay, training, development, career opportunities and innovation management were the aspects considered in the CFR study, which awarded 25 firms in the automotive sector, from big car makers to small spare parts suppliers. Having reached its fourth edition, the study was conducted in collaboration with the AT Kearney consulting company, CAR (Center for Automotive Research), the University of Duisburg-Essen and the German Automotive Industry Association. In particular, Pirelli stood out in the categories “Primary benefits,” “Career opportunities” and “Innovation management.”

SEPTEMBER

- In Warsaw, Pirelli was the **guest of honour** at the **Cement Sustainability Initiative of the World Business Council for Sustainable Development (WBCSD)**, as the model for **best practice** in terms of management focused on continuous improvement of health and safety at the workplace. According to a study carried out by the Cement Sustainability Initiative, Pirelli practices were the best of all study participants belonging to the auto parts and tyres sector.
- In Germany, “**Exemplary**” was the final judgement of “**Autobild**,” which did not find any drawbacks with the **Pirelli Cinturato P7**, remarking on “its convincing talent, and satisfying energy savings characteristics; its smooth driving performance, with stable grip on curves and limited braking distances both on dry and wet pavement; its quiet ride.”
- Following the 2010 revision of the Dow Jones indices carried out by SAM Group, the Swiss asset manager responsible for assessment, admission or exclusion of the companies from the Dow Jones sustainability equity indices – **Pirelli was confirmed global Sustainability Leader in the Autoparts & Tires**

sector for the fourth year in a row, as part of the Dow Jones Sustainability World and Europe indices. For the second year in a row, Pirelli is also the only Italian company to be ranked as a world leader in its own sector.

JULY

- In London, Pirelli won the “**Country Award 2010**” for Italy, handed out by the authoritative IR Magazine Europe to the best companies and professionals in investor relations. The award was decided by over 700 domestic and international analysts and investors.

MAY

- In China Pirelli was judged the best brand on the spare parts market by the “**China Automobile Aftermarket Summit**,” the forum that was held at the end of April in Beijing and sponsored by the prestigious magazine **Motor Trend**. Twenty-seven tyre brands competed for the prize, which was awarded by sector experts participating at the forum who declared Pirelli “**Recommended Brand**” for 2010. The principal theme of the conference was the state of the art of the spare parts market, ranging from technology to marketing, with an analysis of the future.

APRIL

- Pirelli received another important award in the **United States**. On April 23 it participated at the **Ford World Excellence Award** ceremony in Dearborn, Michigan, receiving the prestigious prize for its **excellent performance** as measured by quality, cost and delivery in 2009. The star player for this award was the **tyre plant at Guacara**, Venezuela, which supplies Pirelli tyres to Ford.
- Another prize won by Pirelli in the **United States** was the prestigious **JD Power & Associates Award** for its **high performance tyres for sports cars**, which were found to be the favourite brand in the segment according to the “**Original Equipment Tire Satisfaction Index Study**” conducted by **JD Power & Associates**, which surveys the general level of motorist satisfaction every year.

FEBRUARY

- **Cinturato P7 and P6** passed with flying colours the tests held by **ADAC**, the most important and prestigious Automobil-Club in Germany and Europe, with over 19 million members. Pirelli thus

confirmed its leadership in terms of performance, safety and eco-compatibility, proving once again that it had internalised the philosophy and core values of **Green Performance**. The test results, which were also published by the automobile clubs of Austria and Switzerland (TCS and OAMTC), showed how the **Cinturato P7** and **P6** tyres are extremely reliable for users. **Pirelli Cinturato P7** turned out to be the best in reconciling high performance on both wet and dry pavement, with low rolling resistance, higher mileage and quieter ride. The **Cinturato P6** posted the same results, not only by beating all its competitors in the tests, but also by being **the only tyre classified in the Green Performance category**. These results have rewarded Pirelli’s approach, enabling it to win a leading position by combining safety, performance and eco-compatibility.

JANUARY

- Pirelli was the **tyre brand of the year in Nigeria**. The awards ceremony of the Nigeria Auto Media Awards was held in the capital city of Lagos on January 21. This competition was organised by the specialised car and transport press. Pirelli won the **Diamond Jewel Award** in the tyre category, as “**Tyre Brand of the Year 2009**”.
- In the presence of over 500 participating suppliers and automotive companies, Pirelli **Japan** won the **Autobacs Award 2009** in Tokyo as the best tyre supplier of the year. Autobacs, an historic Japanese reseller of spare parts and accessories for cars founded in 1947 and having operations worldwide, awarded Pirelli for the significant contribution it made to sales in 2009. The driver for this success was the **P4 Four Season**. For Pirelli Tyre, the Autobacs award represents a major success, the result of effective **teamwork** between headquarters, Pirelli China and Pirelli Japan, which collaborated on the project from the beginning.

For a complete, detailed overview of the awards and recognition received by the Group in 2009, please see the Sustainability section in the **Sustainability Channel** area on the website www.pirelli.com.