



Pirelli & C. S.p.A.

**SHAREHOLDERS' MEETING 20/21 APRIL 2011
reports of the Board of Directors**

Remuneration Group Report

Remuneration Group Report

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Foreword

The General Remuneration Policy for the year 2011 (“Policy”) sets out the principles and guidelines which the Pirelli Group refers to in order to (i) determine and (ii) monitor the implementation (of) the remuneration practices described below.

The Policy has been drafted in the light of the recommendations contained in Article 7 of the Self-Governance Code of Borsa Italiana S.p.A., as amended in March 2010, which Pirelli has adopted and which will enter into force as from the financial year 2012, and for the effects of Article 14 of the Procedure for Related-Party Transactions approved by the Company's Board of Directors on November 3, 2010.

The 2010 Statement, presented for information purposes to the Shareholders' Meeting, provides a final statement about remunerations for the year 2010.

To make it easier to read and understand this Report, please find below a glossary of the terms most frequently used herein:

Target-based Annual Total Direct Compensation: the sum of (i) the gross annual fixed component of remuneration, (ii) the annual variable component that is based on the achievement of given target-based objectives, (iii) the medium/long term annualization of the variable component (the so-called LTI) that is based on the achievement of medium/long-term target-based objectives;

General Directors: those appointed by the Board of Directors in connection with the organizational structure of the Company and the Group.

Managers with strategic responsibilities: the managers identified by the Board of Directors of the Company, who have the power or responsibility to plan and control the Company's activities or to take decisions which may affect its development or future prospects.

Executives: Pirelli Group employees who meet specific requirements, set out in more detail in the Application Criteria (as defined in paragraph 1 of the Policy), which take account of the employee's position within the organizational structure, his autonomy, his decision-making power with respect to the company's choices, his potential and performances.

Group or Pirelli Group: all the companies included in the consolidation of Pirelli & C. S.p.A..

Management: General Directors, Managers with strategic responsibilities, Senior Managers and Executives taken as a whole;

MBO: the annual variable component of remuneration that is based on the achievement of pre-set business objectives;

LTI Plan: the Long Term Incentive Cash Plan described in paragraph 9 of this Policy;

Pirelli & C.: Pirelli & C. S.p.A.

GAS: the gross annual fixed component of remuneration of the employees of any Group Company;

Senior Managers: the managers whom (i) Directors holding special offices and who are assigned specific functions and (ii) the General Directors of the Company whose activities have a significant impact on business results, first report to.

Company: Pirelli & C. S.p.A.

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General Remuneration Policy for the year 2011

1. Principles

The Company defines and applies a General Remuneration Policy that is designed to attract, motivate and retain the resources that have the professional skills necessary to successfully pursue the Group's objectives.

The Policy is defined so as to align the interests of the Management with those of shareholders, pursuing the primary objective of creating sustainable value in the medium-long term through the creation of a strong link between remuneration, on the one hand, and individual and Group performances, on the other.

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

The Board of Directors adopts, upon proposal of the Remuneration Committee, the "Criteria for the Implementation of the General Remuneration Policy" ("**Application Criteria**").

Any deviations from the Application Criteria when setting the remuneration:

- of Directors holding special offices, of General Directors and of Managers with strategic responsibilities, are first examined and approved by the Remuneration Committee and the Board of Directors;
- of Senior Managers and Executives are first approved by the Chief People Officer of the Company.

At least once a year, during the presentation of the Remuneration Statement, the Chief People Officer reports about compliance with the Policy and about the corresponding Application Criteria to the Remuneration Committee.

2. Remuneration Committee

Since 2000, the Board of Directors has established among its members the "Remuneration Committee" that has investigative, advisory and proactive functions. In particular, the Remuneration Committee:

- ❖ makes proposals to the Board of Directors for the remuneration of Directors holding special offices so as to ensure its alignment with the objective of creating value for shareholders over the medium-long term;
- ❖ periodically reviews the remuneration criteria that are applied to the Company's Management and, upon request of the Directors holding special offices who are assigned specific functions, makes proposals and recommendations on this issue, especially for the adoption of stock option/share-allocation plans;
- ❖ monitors the implementation of all decisions taken and of corporate policies on remuneration.

The members of the Remuneration Committee, appointed by the Board of Directors during the meetings of April 29, 2008 (Directors Berardino Libonati, Alberto Bombassei, Giampiero Pesenti) and July 29, 2009 (Director Umberto Paolucci), are all independent directors.

On November 30, 2010, Director Berardino Libonati (Chairman) passed away. Consequently, at the time of this Report, the Remuneration Committee's members are:

- Alberto Bombassei;
- Umberto Paolucci;
- Giampiero Pesenti

The Board of Directors has granted the Remuneration Committee the powers of the Committee for Related-Party Transactions though solely with respect to any decisions regarding the remuneration of Directors holding special offices and of Managers with strategic responsibilities.

For a full description of the operation and activities carried out in 2010 by the Remuneration Committee, please refer to the Report on Corporate Governance and Ownership Structure for the year 2010.

3. Process for the definition and adoption of the Policy

The Policy is submitted by the Remuneration Committee to the Board of Directors every year.

The Board of Directors, after reviewing and approving the Policy, submits it to the advisory vote of the Shareholders' Meeting.

The Remuneration Committee submits also the “Application Criteria” to the Board of Directors' approval and oversees their implementation.

The Policy, which was approved by the Remuneration Committee at its meeting on February 23, 2011, was also evaluated during a specific meeting of all Independent Directors; it was then approved by the Board of Directors at its meeting on March 8, 2011 and submitted to the examination and advisory vote of this Shareholders' Meeting.

4. Contents of Policy

The Policy, as stated above, sets out the principles and guidelines which:

- (i) the Board of Directors follows when setting the remuneration of:
 - the members of the Board of Directors and in particular of Directors holding special offices;
 - General Directors;
 - Managers with strategic responsibilities:
- (ii) the Group refers to in order to set the remuneration of Senior Managers and, in general, that of the Executives of the Group.

5. The remuneration of Directors

Within the Board of Directors, we can distinguish between:

- (i) Directors holding special offices, who may also be assigned specific functions;
- (ii) Directors who do not hold special offices.

The granting of powers to Directors only for urgent matters does not qualify them as Directors who have been assigned specific functions.

As of December 31, 2010:

- the Chairman of the Board of Directors, Marco Tronchetti Provera, and the Deputy Chairmen, Alberto Pirelli and Vittorio Malacalza, were Directors holding special offices; the Chairman had also been assigned specific functions (for further information on this issue, please refer to the Report on Corporate Governance and Ownership Structure);
- the following Directors did not hold special offices: Carlo Acutis; Carlo Angelici; Cristiano Antonelli; Gilberto Benetton; Alberto Bombassei; Franco Bruni; Luigi Campiglio; Enrico Tommaso Cucchiani; Giulia Maria Ligresti; Massimo Moratti; Renato Pagliaro; Umberto Paolucci; Giovanni Perissinotto; Giampiero Pesenti; Luigi Roth; Carlo Secchi.

In April 2008, the Shareholders' Assembly of Pirelli, upon appointment of the Board of Directors, set the Directors' total remuneration (under art. 2389(1) Italian Civil Code), granting the Board of Directors the task of determining its allocation.

In particular, the Shareholders' Assembly of April 2008 approved a total gross annual remuneration of €1.2 million, allocated as follows by the Board of Directors:

- €50,000 for each member of the Board of Directors;
- €24,000 for each member of the Internal Audit, Risk and Corporate Governance Committee;
- €20,000 for each member of the Remuneration Committee.

In line with best practices, Directors not holding special offices (as defined above) were not granted a variable component of their remuneration.

A €15,000 salary was granted to the Director who was a member of the Supervisory Board.

Directors were also entitled to a refund of expenses incurred for business reasons.

In line with best practices, the Company applies an insurance policy called D&O (*Directors & Officers*) *Liability* covering the third party liability of corporate bodies, General Directors, Managers with strategic responsibilities, Senior Managers and

Executives in the performance of their functions, which is designed to indemnify the Group against the cost of any ensuing compensation deriving from the relevant provisions of the applicable national collective agreement and from the provisions on assignments, though excluding the case of willful misconduct and gross negligence.

Please note that upon approval of the Financial Statements of the year that ended on December 31, 2010, the Shareholders' Assembly will also be required to renew the Board of Directors.

6. Remuneration of Directors holding special offices

At the time of their appointment or at the first meeting thereafter, the Remuneration Committee proposes to the Board of Directors the remuneration package for Directors holding special offices.

The remuneration package of Directors holding special offices generally consists of the following elements:

- a gross annual fixed component;
- an annual variable component that is based on the achievement of pre-set business objectives (the so-called MBO);
- a medium/long term, variable component (the so-called LTI).

When setting remuneration and its single elements, the Board of Directors takes into account whether the Director holding a special office has been assigned specific functions. In particular, salary levels are set on the basis of the following indicative criteria:

- a. the fixed component generally represents no more than 50% of the target-based Annual Total Direct Compensation;
- b. the (annual) target-based MBO incentive is a predetermined percentage of the fixed salary of Directors holding special offices in the Company (excluding, therefore, the remuneration received for other offices in other Group companies) representing generally not less than 70% of their salary. In any case, the maximum incentive can not be 2 times greater than the gross annual fixed component/GAS;
- c. The medium/long term, variable, target-based annualized component (the so-called LTI) generally represents at least 50% of the total variable component (target-based MBO and target-based LTI) of the target-based Annual Total Direct Compensation.

For further information, also about maximum incentive limits, please refer to paragraph 9 (“MBO and LTI Plan”).

If a Director holds special offices though is not assigned specific functions, his remuneration package consists exclusively of an annual fixed component that takes into account the particular office held thereby.

With reference to the variable components of the remuneration package of Directors holding special offices, please note that the Remuneration Committee proposes the MBO objectives to the Board of Directors on an annual basis and then checks, in the following year, the Directors' performances to verify their achievement of the MBO objectives in the previous year.

The Remuneration Committee is also responsible for evaluating the proposed allocation and quantification of the LTI in case of achievement of the objectives of the LTI Plan.

By analogy with what is guaranteed by law and/or by the National Collective Agreement for the Italian managers of the Group, the Board of Directors may also grant Directors holding special offices and who have been assigned specific functions, provided they do not have a management contract with the Group:

- a Retirement Bonus (Trattamento di Fine Mandato -T.F.M.) as under art. 17(1), letter c) of the Consolidated Income Tax Law No 917/1986 with characteristics similar to those of the Severance Pay (Trattamento di Fine Rapporto - TFR) as under art. 2120 Italian Civil Code, granted by law to the Italian managers of the Group and including the contributions to be paid by the employer which would be due to social security institutions or funds in the case of a management contract with the Group..
- a policy (i) against personal accidents occurred while fulfilling their assignment, and (ii) against extra-professional accidents with premiums charged to the Company; for the latter accidents, the premium is payable by the Company according to tax and fiscal regulations;
- compensation in case of permanent disability and death due to disease;
- further benefits typical of their office and currently granted within the Group to Managers with strategic responsibilities and/or Senior Managers.

The Board of Directors may provide for (or, if required by law, may suggest to the Shareholders' Assembly) incentive mechanisms through the award of financial instruments or options on financial instruments which, where approved, are disclosed in the Annual Remuneration Statement at the latest (without prejudice to any further transparency obligations required by applicable laws).

As of the date of this Report, the Company has no incentive plans through financial instruments.

It is a policy of the Group not to award discretionary bonuses to Directors holding special offices.

The Board of Directors, upon proposal of the Remuneration Committee, may grant bonuses to these figures for specific transactions that are deemed exceptional in terms of strategic importance and effects on the results of the Company and/or the Group.

The Remuneration Committee and the Board of Directors evaluate and approve in advance, respectively, any further remuneration elements awarded to Directors for any other special offices granted thereto within the Boards of Directors of the Company's subsidiaries.

It is up to the Remuneration Committee and to the Board of Directors to analyse the composition and, more generally, the competitiveness of the remuneration packages of Directors holding special offices. When doing so, they are assisted by independent firms specialized in executive compensation on the basis of methodological approaches that allow for the complexity of the Directors' offices to be assessed in organizational terms, according to their specific assigned functions and to their individual impact on final business results.

7. General Directors and Managers with strategic responsibilities

As of December 31, 2010, Mr. Francesco Gori was the sole General Director of Pirelli & C., while the Managers with strategic responsibilities were:

- Atty. Francesco Chiappetta;
- Mr. Francesco Tanzi;

- Mr. Maurizio Sala.

The Board of Directors, assisted by the Internal Audit, Risk and Corporate Governance Committee, checks at least once a year that these conditions are not met with respect to further executives of the Company and/or the Group.

The remuneration package of General Directors and of Managers with strategic responsibilities generally consists of the following elements:

- a gross annual fixed component (the so-called GAS);
- an annual variable component that is based on the achievement of pre-set business objectives (the so-called MBO);
- a medium/long term, variable component (the so-called LTI).
- benefits typically granted to Pirelli executives.

When setting remuneration and its single elements, the Board of Directors considers the following indicative criteria:

- a. the fixed component generally represents no more than 50% of the target-based Annual Total Direct Compensation;
- b. the (annual) target-based MBO incentive for General Directors is a predetermined percentage of their fixed gross annual salary, representing generally not less than 70% of their salary, while for Managers with strategic responsibilities it represents not less than 40% of their fixed gross annual salary.
- c. The medium/long term, variable, target-based annualized component (the so-called LTI) generally represents at least 50% of the total variable component (target-based MBO and target-based LTI) of the target-based Annual Total Direct Compensation.

For further information, also about maximum incentive limits, please refer to paragraph 9 (“MBO and LTI Plan”).

Just like for Directors holding special offices, the Board of Directors may provide for (or, if required by law, may suggest to the Shareholders' Assembly) incentive mechanisms through the award of financial instruments or options on financial instruments which, where approved, are disclosed in the Annual Remuneration Statement of the following year at the latest (without prejudice to any further transparency obligations required by applicable laws).

As said in the previous paragraph, as of the date of this Report the Company has no incentive plans through financial instruments.

It is a policy of the Group not to award discretionary bonuses to General Directors and to Managers with strategic responsibilities.

The Board of Directors, upon proposal of the Remuneration Committee, may grant bonuses to these figures for specific transactions that are deemed exceptional in terms of strategic importance and effects on the results of the Company and/or the Group.

The process for setting the remuneration of General Directors is similar to that described for Directors holding special offices.

With regard to Managers with strategic responsibilities, the Remuneration Committee checks whether their remuneration is consistent with the Policy.

Also the remuneration of General Directors and of Managers with strategic responsibilities is analyzed with the assistance of independent firms specialized in executive compensation, and its levels are reviewed annually and announced in the Annual Remuneration Statement.

8. Senior Managers and Executives

The remuneration package of Senior Managers and Executives in general consists of the following elements:

- a gross annual fixed component (the so-called GAS);
- an annual variable component that is based on the achievement of pre-set business objectives (the so-called MBO);
- a medium/long term, variable component (the so-called LTI).
- benefits granted according to corporate practices.

When setting the remuneration of Senior Managers and Executives and its single elements, the Pirelli Group considers the following indicative criteria:

- a. the fixed component: (i) for Senior Managers generally represents no more than 60% of the target-based Annual Total Direct Compensation and (ii) for Executives it generally represents no more than two thirds of the target-based Annual Total Direct Compensation;
- b. an (annual) target-based MBO incentive that is a percentage of the fixed component;
- c. The medium/long term, variable, target-based annualized component (the so-called LTI) (i) for Senior Managers represents at least 50% of the total variable component (target-based MBO and target-based LTI) of the target-based Annual Total Direct

Compensation and (ii) for Executives (unless the executive is not included, for management purposes, in the LTI Plan) it represents at least 30% of the total variable component (target-based MBO and target-based LTI) of the target-based Annual Total Direct Compensation.

For further information, also about maximum incentive limits, please refer to paragraph 9 (“MBO and LTI Plan”).

The Group may grant exceptional bonuses in case of urgent management needs or in case of the achievement of specific extraordinary targets, and may include these workers in incentive mechanisms through the allocation of financial instruments or options on financial instruments adopted by the Group. In this respect, as said above, as of the date of this Report the Company has no incentive plans through financial instruments.

9. MBO and LTI Plan

The annual variable component (the so-called MBO) is used to evaluate the recipient's performance on an annual basis. The MBO objectives for Directors holding special offices and who are assigned specific functions, of General Directors and of Managers with strategic responsibilities, are set by the Board of Directors upon proposal of the Remuneration Committee, and are connected to the Company's and the Group's annual performances.

The annual variable component is based on the achievement of a financial condition of access (the so-called on/off condition) - in 2010, the Net Financial Position - and is related to a quantitative benchmark of annual profitability (in 2010, PBIT).

The MBOs of Senior Managers and Executives are defined by their hierarchical superiors together with the HR Department and the Group Management Control Department and may include, in addition to the Company's and/or Group's performances, objectives related to the economic and/or quality performance of the unit/function which the worker is a member of.

The Group sets a "cap" on the incentive payable in case the target objectives are exceeded.

In particular, in the case of MBOs granted to Directors holding special offices and to General Directors, the maximum incentive can not be 2 times greater than the gross

annual fixed component/GAS. In the case of Managers with strategic responsibilities, the maximum incentive can not be 1.5 times greater than their GAS. Lastly, the maximum incentive for Senior Managers and Executives cannot be 2 times greater than the target-based incentive.

Also for the purposes of fostering the achievement of medium/long term interests, the Group has adopted since 2009 a medium/long term incentive system that is based on the achievement of the objectives set out in the three-year plan (the "2009/2011" plan - involving some 90 people, in particular Directors holding special offices and who are assigned specific functions, General Directors, Managers with strategic responsibilities, Senior Managers and some Executives - and then the "2011/2013" plan, essentially extended to all other Executives of the Group).

The LTI Plan also includes a mechanism for the "co-investment" of a portion of the MBO: the participant in the LTI Plan "co-invests" 50% of his MBO 2011 and 2012, eventually achieved thereby, to "support" the achievement of the objectives of the Three-Year Business Plan.

If the objectives of the Three-Year Business Plan are achieved, the participant acquires an LTI incentive which is a percentage of his gross annual fixed component/GAS applied at the time of joining the Plan; this percentage takes into account the role played thereby. The maximum incentive cannot be 1.5 times greater than the incentive granted for the achievement of target objectives.

In case of failure to achieve the target objectives, the worker is not entitled, not even pro-rata, to receive the LTI incentive.

With regard to the portion of co-invested MBO, the worker - if the three-year objectives are achieved - may claim the "return" of the "invested" amount, increased by a sum amounting to the "invested" one; if the three-year objectives are not achieved, the worker is entitled to claim only a refund of half the amount invested.

Therefore, the incentive plan provides for the partial deferment of payment of MBOs 2011 and 2012 (and of MBOs 2009 and 2010 for the LTI Plan 2009/2011).

The costs of LTI incentives are included in the objectives of the Three-Year Business Plan, so that the cost of the LTI Plan is "self-financed" by the achievement of these objectives.

The allocation of a portion of the amount granted on top of the "invested" one (10% of that amount) is connected to the Total Shareholder Return, which measures Pirelli performances compared to the FTSE/MIB Total Return index, periodically calculated by FTSE and available in the Italian Stock Exchange database, which Pirelli's TSR must be at least aligned with in order to ensure an even greater alignment between the Management's performances and the expectations of shareholders. This relation is aimed at guaranteeing a direct link between pay and sustainable performances, meant in terms of value growth in the medium and long term.

The LTI Plan also has retention purposes: in the event of termination, for any reason, of the worker's assignment and/or employment relationship before the end of the three-year period, the worker no longer takes part in the Plan and thus the three-year incentive is not paid thereto, not even pro-rata (this applies also to MBO shares that may have already been "invested").

10. Allowances in the event of resignation, dismissal or termination

It is a policy of the Pirelli Group not to enter into agreements with Directors, Managers with strategic responsibilities, Senior Managers and Executives that regulate *ex ante* the economic issues arising in case of early termination of their relationship by the Company or the worker (the so-called "golden parachutes").

If the worker's relationship with the Group is terminated other than for good cause, it is preferable to "close" the relationship by mutual agreement. Subject to statutory and/or contractual obligations, any agreement on termination of the worker's relationship with the Group is based on the applicable benchmarks in this field and is subject to the case-law/customary limits applied in the country where the agreement is reached.

The Company defines internally the criteria which also the other companies of the Group must follow for the management of agreements on the early termination of relationships with managers and/or Directors holding special offices.

With regard to Directors holding special offices and who are assigned specific functions and who do not have a management contract with the Group, the Company does not provide for the payment of allowances or extraordinary compensation related to termination of their office. Payment of a specific allowance may be granted, subject to the prior assessment of the competent corporate bodies, in the following cases:

- termination by the Company without good cause
- termination by the Director for good cause; for example, in case of substantial changes to his role or to his assignments and/or in case of a so-called "hostile" tender offer.

In these cases, the allowance amounts to 3 times the worker's gross annual salary, this meaning the sum of (all gross annual fixed salaries for the offices held; the average annual MBO paid while in office; Severance Pay on these amounts).

11. Non-competition agreements

The Group may enter into non-competition agreements with its General Directors, Managers with strategic responsibilities and for especially important professional roles of Senior Managers and Executives, providing for payment of a GAS-related fee in relation to the term and scope of the obligation resulting from the agreement itself.

The obligation is referred to the industry which the Group works in at the time of the agreement and to its geographical scope. The scope of the obligation varies according to the worker's role at the time of execution of the agreement and may cover, as in the case of General Directors, all the countries which the Group works in.