

21. PROVISIONS FOR LIABILITIES AND CHARGES

The changes that occurred during the period are shown below

PROVISION FOR LIABILITIES AND CHARGES - NON-CURRENT PORTION (in thousands of euro)

Opening balance	142,230
Translation differences	(15,294)
Increases	17,806
Uses	(19,192)
Reversals	(13,585)
Other	4,780
Closing balance at 31 December 2013	116,745

The **non-current portion of provisions for liabilities and charges** mainly refer to accruals made by the Brazilian subsidiary Pirelli Pneus Ltda for lawsuits and tax litigation (euro 45,223 thousand) and labour lawsuits (euro 30,239 thousand) and by the parent company Pirelli & C. S.p.A. for tax litigation (euro 19,067 thousand) and commercial risks, site remediation and labour disputes (euro 18,101 thousand).

The **increases** mainly refer to accruals for labour disputes of the subsidiary Pirelli Pneus Ltda – Brazil.

The **uses** relate to costs incurred, mainly in labour lawsuits by the subsidiary Pirelli Pneus Ltda – Brazil and in labour lawsuits and site clean-up by the parent company Pirelli & C. S.p.A.

The **reversals** of excess provisions were largely related to tax litigation involving the parent company Pirelli & C. S.p.A. (euro 7,038 thousand) for challenges that were extinguished when the appellate court decisions against the Italian Revenue Agency (Agenzia delle Entrate) became final after that agency did not appeal to the Court of Cassation (the highest court of appeal in Italy), provisions related to license concession as at the parent company Pirelli & C. S.p.A. (euro 4,706 thousand) when the risk ceased to exist.

PROVISION FOR LIABILITIES AND CHARGES - CURRENT PORTION (in thousands of euro)

Opening balance	110,839
Translation differences	(4,296)
Increases	25,771
Uses	(19,877)
Reversals	(16,128)
Other	(6,220)
Closing balance at 31 December 2013	90,089

The **current portion of provisions for liabilities and charges** mainly include accruals for technical claims and product warranties (euro 22,815 thousand), site remediation of disused area of land (euro 8,042 thousand), reorganisation and closure of business units (euro 16,521 thousand), litigation for occupational diseases (euro 10,780 thousand), tax risks (euro 4,390 thousand), labour lawsuits (euro 4,117 thousand), industrial accident insurance (euro 4,601 thousand) and legal lawsuits (euro 3,883 thousand).

The **increases** mainly refer to provisions for product claims, occupational diseases, civil lawsuits and reorganisation or closure of activities.

The **uses** are mainly related to costs incurred to close pending actions against business units domiciled in Italy for occupational disease lawsuits and in Germany for corporate reorganisation.

The **reversals** of excess provisions mainly concerned technical claims (euro 8,270 thousand), product warranties (euro 1,663 thousand) and labour lawsuits (euro 1,512 thousand).

22. EMPLOYEE BENEFIT OBLIGATIONS

This item includes

(in thousands of euro)

	12.31.2013	12.31.2012
Pension funds:		
● funded	222,242	271,288
● unfunded	93,763	99,681
Employees' leaving indemnity (Italian companies)	44,496	47,007
Healthcare plans	17,333	20,403
Other long term benefits	61,616	84,578
	439,450	522,957

Pension funds

The following table shows the breakdown of pension funds at December 31, 2013

(in migliaia di euro)

	12.31.2013						
	Germany	Sweden	Total unfunded pension funds	USA	UK	Other countries	Total funded pension funds
Funded funds							
Present value of funded liabilities				124,986	973,635	4,527	1,103,148
Fair value of plan assets				(98,799)	(778,403)	(3,704)	(880,906)
Unfunded funds							
Present value of unfunded liabilities	90,087	3,676	93,763				
Net liabilities recognised	90,087	3,676	93,763	26,187	195,232	823	222,242

The following table shows the breakdown of pension funds at December 31, 2012

(in thousands of euro)

	12.31.2012						
	Germany	Sweden	Total unfunded pension funds	USA	UK	Other countries	Total funded pension funds
Funded funds							
Present value of funded liabilities				145,518	974,197	4,517	1,124,232
Fair value of plan assets				(94,134)	(755,093)	(3,717)	(852,944)
Unfunded funds							
Present value of unfunded liabilities	95,693	3,988	99,681				
Net liabilities recognised	95,693	3,988	99,681	51,384	219,104	800	271,288

The characteristics of the principal pension funds in place at December 31, 2013 are summarized below:

- **Germany:** this is an unfunded defined-benefit plan based on the last salary. It provides a pension in addition to the state pension. The plan was closed in October 1982; consequently the participants to this plan are employees whose employment began prior to that date;
- **USA:** this is a funded defined-benefit plan based on the last salary. It provides a pension in addition to the state pension and is administered by a trust. The plan was closed in 2001 and frozen in 2003 for employees who were transferred to a defined-contribution scheme. All participants to this plan have retired;
- **UK:** these are funded defined-benefit plans based on the last salary. They provide a pension in addition to the state pension and are administered in trusts. These plans were closed in 2001. The Pirelli Tyres Ltd plan was frozen in 2010 for employees hired before 2001, who were transferred to a defined contribution plan. The plan operated by the subsidiary Pirelli UK Ltd, which includes the employees in the Cables and Systems segment sold in 2005, was already frozen at the date of the sale in 2005;
- **Sweden:** this involves a defined benefits plan (ITP2), which was closed to new participants, and the only participants are retired employees and recipients of deferred pensions.

The following changes occurred in the net liabilities in 2013

(in migliaia di euro)

	Present value of obligation	Fair value of plan assets	Total
Opening balance at 1 January 2013	1,223,913	(852,944)	370,969
Exchange difference	(26,077)	19,646	(6,431)
Movements through income statement:			
● Current service cost	923		923
● interest expense / (income)	50,201	(36,347)	13,854
	51,124	(36,347)	14,777
Remeasurements recognized in equity:			
● (gain) loss from change in demographic assumptions	(13,089)		(13,089)
● (gain) loss from change in financial assumptions	20,009		20,009
● experience (gains) losses	(1,702)		(1,702)
● return on plan assets, excluding amounts included in interest income		(23,376)	(23,376)
	5,218	(23,376)	(18,158)
Employer's contributions	-	(45,888)	(45,888)
Plan participants' contributions	28	(28)	-
Benefits paid	(56,865)	56,865	-
Other	(429)	1,165	736
Closing balance at 31 December 2013	1,196,912	(880,907)	316,005

The following changes occurred in the net liabilities in 2012

(in thousands of euro)

	Present value of obligation	Fair value of plan assets	Total
Opening balance at 1 January 2012	1,160,622	(809,204)	351,419
Exchange difference	18,788	(14,915)	3,873
Business combination	3,278		3,278
Movements through income statement:			
● Current service cost	811		811
● interest expense / (income)	55,326	(39,544)	15,782
	56,137	(39,544)	16,593
Remeasurements recognized in equity:			
● (gain) loss from change in demographic assumptions	-		-
● (gain) loss from change in financial assumptions	51,753		51,753
● experience (gains) losses	(3,142)		(3,142)
● return on plan assets, excluding amounts included in interest income		(5,298)	(5,298)
	48,611	(5,298)	43,313
Employer's contributions		(47,508)	(47,508)
Plan participants' contributions	27	(27)	-
Benefits paid	(63,109)	63,109	-
Other	(441)	441	-
Closing balance at 31 December 2012 *	1,223,913	(852,944)	370,969

* The figures of 2012 have been restated due to the new standard IAS 19 revised "employee benefits" being effective from 1.1.2013

The service cost is included in the item "Personnel expense" (note 31), while the interest expense / (income) is included in the item "Financial expenses" (note 36).

The following table shows the breakdown of funded pension fund assets

(in thousands of euro)

	12.31.2013				12.31.2012			
	listed	unlisted	total	%	listed	unlisted	total	%
Shares	70,300	170,224	240,523	27%	44,583	110,162	154,745	18%
Bonds	75,664	115,653	191,318	22%	56,506	166,010	222,516	26%
Insurances	-	3,704	3,704	0%	-	3,717	3,717	1%
Deposits	102,145	43,221	145,366	17%	-	211,270	211,270	25%
Balanced funds	-	250,004	250,004	28%	-	233,239	233,239	27%
Real Estate	-	29,448	29,448	3%	-	18,499	18,499	2%
Derivatives	8,926	1,934	10,860	1%	-	(590)	(590)	0%
Other	-	9,683	9,683	1%	-	9,549	9,549	1%
	257,036	623,871	880,906	100%	101,089	751,855	852,944	100%

The principal risks to which the Group is exposed in relation to the pension funds are detailed as follows:

- volatility in the assets servicing the plans: to limit the liabilities, the investment strategy privileges assets which are expected to have relatively high and stable returns over the long-term. This implies that certain investments, such as listed shares, feature high volatility over the short term, and that this exposes the plans to risks of reduction in the value of assets in the short-term, consequently increasing liabilities. However, this risk is mitigated by the diversification of the investments into different investment classes, through different investment managers and different investment styles. Moreover, the investments are continuously revised in response to market conditions, with adjustments to maintain the overall risk at adequate levels;
- changes in the yields of bonds and inflation forecasts: forecasts of falling returns on the bonds and/or rising inflation lead to an increase in the value of liabilities. The plans reduce this risk by making investments in "liability hedging" assets. In the United Kingdom, the protection assured by a portfolio of this type was built over the last several years, and in June 2014 the interest rate and inflation rate risks impinging on the liabilities will be fully hedged;
- life expectancy: growing life expectancy entails an increase in the value of plan liabilities. The plans do not protect themselves directly against this risk. The liabilities are measured by using prudent hypotheses whose adequacy is revised periodically.

In the United Kingdom, the management of assets servicing the plans was delegated to an asset manager who manages the assets in relation to a liability benchmark, which approximates the change in value of the liabilities. The key parameters of this mandate may be summarised as follows:

- a mix of assets under dynamic management over time, rather than a fixed strategic allocation;
- hedging of about 70-75% of the risk related to interest and inflation rates – constructed as a percentage of the asset value – through the use of debt instruments (government bonds) and derivatives;
- management of foreign exchange risk with the goal of hedging at least 70% of the exposure to foreign currencies held in the portfolio through use of forward contracts.

In the United Kingdom, the funding arrangements and funding policies are revised once every three years. The next funding review is scheduled to take place in 2014. In the United States, the funding assessments are made annually.

The contributions expected to be paid into the pension funds during 2014 total euro 42,901 thousand.

Employees' leaving indemnities (TFR)

Employees' leaving indemnities (for Italian companies) changed as follows

(in thousands of euro)

	12.31.2013	12.31.2012
Opening balance	47,007	40,484
Movements through Income Statement:		
● Current service cost	236	259
● Interest cost	1,446	1,772
Remeasurements through equity:		
● actuarial (gains) losses arising from changes in financial assumptions	(1,230)	7,231
● effect of experience adjustments	(617)	-
Payments/advances	(2,056)	(2,551)
Other	(290)	(188)
Closing balance	44,496	47,007

The service cost is included in the item "Personnel expense" (note 31), while the interest expense is included in the item "Financial expenses" (note 36).

Healthcare plans

This item refers exclusively to the healthcare plan in place in the United States subsidiary

(in thousands of euro)

	USA
Liabilities recognised at 12.31.2013	17,333
Liabilities recognised at 12.31.2012	20,403

The following changes occurred during the period

(in thousands of euro)

	12.31.2013	12.31.2012 Restated
Opening balance	20,403	21,270
Translation differences	(799)	(399)
Movements through Income Statement:		
● current service cost	5	4
● interest cost	710	881
Remeasurements through equity:		
● actuarial (gains) losses arising from changes in financial assumptions	(968)	1,535
● effect of experience adjustments	(777)	(1,575)
Benefits paid	(1,240)	(1,312)
Closing balance	17,333	20,403

The service cost is included in the item "Personnel expense" (note 31), while the interest expense is included in the item "Financial expenses" (note 36).

The contributions expected to be paid into the healthcare plan during 2014 total euro 1,397 thousand.

Additional information regarding post-employment benefits

Net actuarial losses accrued in 2013 and recognised directly in equity totalled euro 22,823 thousand (at December 31, 2012 net actuarial losses totalled euro 52,713 thousand).

The principal actuarial assumptions used at **December 31, 2013** are as follows

	Italy	Germany	Netherlands	Sweden	UK	USA
Discount rate	3.40%	3.40%	3.40%	4.00%	4.70%	4.40%
Inflation rate	2.00%	2.00%	2.00%	2.00%	3.33%	-
Expected rate of wage and salary increases	-	3.00%	2.00%	-	-	-
Healthcare cost trend rates - initial	-	-	-	-	-	7.50%
Healthcare cost trend rates - final	-	-	-	-	-	4.50%

The principal actuarial assumptions used at **December 31, 2012** were as follows

	Italy	Germany	Netherlands	Sweden	UK	USA
Discount rate	3.15%	3.15%	3.15%	3.60%	4,55% - 4,60%	3.75%
Inflation rate	2.00%	2.00%	2.00%	2.00%	2,80% - 2,90%	-
Expected rate of wage and salary increases	-	3.00%	2.00%	-	-	-
Healthcare cost trend rates - initial	-	-	-	-	-	7.50%
Healthcare cost trend rates - final	-	-	-	-	-	4.50%

The following table shows the analysis of the payment by due dates related to the post-employment benefits

(in thousands of euro)

	within 1 year	1 to 2 years	3 to 5 years	over 5 years	Total
Pension funds	58,232	59,104	182,672	321,719	621,727
Employees' leaving indemnities (TFR)	1,754	1,675	6,121	31,843	41,393
Healthcare plan	1,397	1,378	4,104	6,376	13,255
	61,383	62,157	192,897	359,938	676,375

The weighted average duration of the obligations for post-employment benefits is 15.72 years.

The following table sets forth the sensitivity analysis for the relevant actuarial assumptions at the end of the financial year

(in %)

	Impact on defined benefit obligation				
	Change in assumption	Increase in assumption		Decrease in assumption	
Discount rate	0.25%	decrease by	3.73%	increase by	3.97%
Inflation rate (only UK plans)	0.25%	increase by	3.48%	decrease by	3.49%

The sole purpose of the analysis above consists in estimating the change in liability according to changes in the discount rates and inflation rate in the United Kingdom close to the principal assumption of the rates themselves, rather than referring to an alternative set of assumptions.

The sensitivity analysis of the liability related to post-employment benefits is based on the same method used to calculate the liability recognised in the Statement of Financial Position.

Other long-term benefits

The table below sets forth the breakdown of other long-term benefits

(in thousands of euro)

	12.31.2013	12.31.2012
Long-term incentive plans	-	12,371
Jubilee awards	16,093	16,419
Leaving indemnities - non Italian companies	34,898	35,931
Other long-term benefits	10,625	19,857
	61,616	84,578

The long-term incentive plans, amounting to euro 12,371 thousand at December 31, 2012, represented the best estimate of the three-year Long Term Incentive 2012-2014 incentive plan reserved for Pirelli Group management. This plan was subordinated on pre-set performance targets being met at the Pirelli & C. S.p.A. Group level during the 2012-2014 period. This plan has been superseded. In fact, the Pirelli Board of Directors decided to terminate the LTI 2012-2014 plan effective December 31, 2013. It was terminated without any full or pro-rated payouts of the three-year incentive. At the same time, the Board of Directors approved adoption of a new plan in connection with the targets for 2014-2016 set out in the Industrial Plan 2013-2017.