

ANNUAL CORPORATE GOVERNANCE REPORT

INTRODUCTION

Telecom Italia has adopted the self-regulatory Code of Conduct drawn up by the Committee for the Corporate Governance of Listed Companies in the ways and within the limits set out here. In fact this section of the report describes the Company's system of corporate governance, which consists of a series of principles, rules and procedures that are updated constantly and, where necessary, adapted to legislative and regulatory developments and changes in international best practice.

As indicated in earlier annual corporate governance reports, **Telecom Italia's system of corporate governance hinges on the central role of the Board of Directors in providing strategic guidance, the complete transparency of operational decisions, both internal and in relation to the market, the efficiency and effectiveness of the internal control system, the strict regulation of potential conflicts of interest and rigorous rules for transactions with related parties.**

In what follows the system is analyzed in the light of the important decisions taken during the year, which saw the completion of the convergence of the Wireline and Mobile telecommunications businesses.

BOARD OF DIRECTORS

Role and tasks

Effective and correct corporate governance requires the Board to play an active role in the strategic guidance of the Company and the control of operations, with powers to direct the business as a whole and intervene in a series of decisions.

In the first place Telecom Italia has embraced the principle that the Board of Directors **has the right (and the duty) to direct the Company's activity and pursue the ultimate objective of creating value for its shareholders.**

To that end, among the tasks **reserved exclusively to the Board** under the Company's Self-Regulatory Code, the following are especially noteworthy:

- examining and approving **strategic, business and financial plans**;
- reviewing and approving **the annual budget**;
- examining and approving **transactions** – including investments and disinvestments – **with a significant impact on the Company's activity in view of their nature, strategic importance or size**;
- verifying the **adequacy of the general organizational and administrative structure** of the Company and the Group;
- preparing and adopting the Company's **corporate governance rules** and the Group's governance guidelines;
- appointing the Supervisory Panel set up under Legislative Decree 231/2001;
- **nominating the persons who are to hold the offices** of Chairman and Managing Director in **strategic subsidiaries**, as well as of **General Manager**;

- **assessing the overall performance of operations**, particularly as regards conflicts of interest and with special account taken of the reports received from the Managing Directors and the Internal Control and Corporate Governance Committee;
- examining and approving the **periodic financial reports**.

Meetings

In 2005 the Board of Directors met **eleven** times. Board meetings were always well attended, with more than **88%** of the directors present on average (the independent directors recorded an attendance rate above **94%**).

When board meetings were to be held, documentation permitting effective participation in the proceedings was normally provided well in advance.

In November 2005 the Company released a calendar providing for five meetings in 2006. It should also be noted that in 2006 Telecom Italia has again opted to publish its annual financial statements and half-yearly report respectively within 90 days of the close of the fiscal year and 75 days of the close of the half year (which allows it to benefit from the exemption from the obligation to prepare the last quarterly report for 2005 and the second quarterly report for 2006).

Appointment of directors

The members of the Board of Directors are elected using the **slate system** (Article 9 of the bylaws). This solution, which means that the Company **does not need to have a nominations committee** and that it also complies with the rules on the appointment of directors introduced by the recent law on the protection of savings, is intended to ensure the presence on the Board of persons elected from slates submitted by minority shareholders (in fact slates may be submitted by shareholders who alone or together with other shareholders hold shares representing at least 1% of the share capital entitled to vote in the ordinary shareholders' meeting).

The present Board of Directors was appointed by the shareholders' meeting of 6 May 2004 on the basis of two slates, one submitted by the majority shareholder of Olimpia S.p.A. and the other by a group of Italian institutional investors.

The slates were accompanied by the profiles of the individual candidates to enable shareholders to evaluate their personal and professional qualifications and, for some candidates, by evidence of their satisfying the requirements laid down in Telecom Italia's Self-Regulatory Code to qualify as independent directors. The résumés submitted when the slates were presented are available on the Company's website under Investors/ Governance.

The composition of the Board changed during the year in connection with the merger of Telecom Italia Mobile S.p.A. into Telecom Italia S.p.A. In fact on 7 April 2005, after approving the merger, the shareholders' meeting **voted to increase the membership of the Board** from 19 to 21 and to appoint two new directors, Marco De Benedetti and Enzo Grilli, both of whom had previously been on the board of Telecom Italia Mobile. These appointments were made without using the slate system, which the bylaws require only when the entire Board has to be appointed. However, the candidacy of Enzo Grilli was put forward by the independent directors, coordinated by the Lead Independent Director, and the two candidates' résumés were made available at the Company's registered office and at the market operating company fifteen days before the shareholders' meeting. Since Enzo Grilli qualifies as independent, Telecom Italia's Board **still has a majority of independent directors** (11 out of 21).

On 26 July 2005, as part of the process of integrating Telecom Italia and Tim, the Board of Directors made Marco De Benedetti a managing director of Telecom Italia, with responsibility for the Mobile Business Unit.

In October the process of integrating fixed and mobile telecommunications was concluded, in terms of corporate structure, with the start of the merger of Tim Italia into Telecom Italia and, from the organizational point of view, with the termination of the separation of operations between the Wireline and Mobile Business Units and the adoption of the “**One Company Model**”. This led to the entire **business being placed under the management of one person**, Mr. Ruggiero. Subsequently, Mr. De Benedetti resigned his directorship and gave up all his operational responsibilities within the Group.

Composition

Telecom Italia’s bylaws provide for the Board of Directors to have not less than 7 and not more than 23 members. The shareholders’ meeting of 7 April 2005 fixed the number of directors at 21 but, following Marco De Benedetti’s resignation, at 31 December 2005 it had 20 members.

Marco Tronchetti Provera	Chairman
Gilberto Benetton	Deputy Chairman
Carlo Buora	Managing Director
Riccardo Ruggiero	Managing Director and General Manager
Paolo Baratta	Member of the Remuneration Committee
John Robert Sotheby Boas	
Giovanni Consorte	
Domenico De Sole	Member of the Internal Control and Corporate Governance Committee and of the Strategy Committee
Francesco Denozza	Member of the Internal Control and Corporate Governance Committee
Luigi Fausti	Chairman of the Remuneration Committee
Guido Ferrarini	Chairman of the Internal Control and Corporate Governance Committee (Lead Independent Director)
Jean Paul Fitoussi	
Enzo Grilli	
Gianni Mion	
Massimo Moratti	
Marco Onado	Member of the Internal Control and Corporate Governance Committee and of the Strategy Committee
Renato Pagliaro	
Pasquale Pistorio	Member of the Remuneration Committee and of the Strategy Committee
Carlo Alessandro Puri Negri	
Luigi Roth	

The composition of the Board changed again on 23 January 2006 following the resignation of Giovanni Consorte and it now has 19 members, of whom 11 are independent.

The positions held by the directors in other listed companies and other large financial, banking and insurance companies are shown below:

Marco Tronchetti Provera	Chairman of Camfin, GPI - Gruppo Partecipazioni Industriali S.p.A., Marco Tronchetti Provera & C. S.a.p.a, Olimpia S.p.A., Pirelli & C. S.p.A. and Pirelli & C. Real Estate S.p.A.
Gilberto Benetton	Chairman of Autogrill S.p.A. and Edizione Holding S.p.A.; Deputy Chairman of Olimpia S.p.A.; Director of Autostrade S.p.A., Benetton Group S.p.A., Lloyd Adriatico S.p.A., Mediobanca S.p.A., Pirelli & C. S.p.A. and Schemaventotto S.p.A.
Carlo Buora	Managing Director of Pirelli & C. S.p.A.; Director of Mediobanca S.p.A., Olimpia S.p.A., Pirelli & C. Real Estate S.p.A., Ras S.p.A. and Rcs Mediagroup S.p.A.
Riccardo Ruggiero	Director of Safilo Group S.p.A.
Paolo Baratta	Director of Banca Finnat Euroamerica and Edizione Holding S.p.A.
John Robert Sotheby Boas	- - -
Domenico De Sole	Director of Delta Airlines and Bausch & Lomb
Francesco Denozza	Chairman of the Board of Auditors of Siemens S.p.A. and member of the Board of Auditors of Siemens Holding
Luigi Fausti	Chairman of Patrimonio Immobiliare dello Stato S.p.A.; Director of Monrif S.p.A.
Guido Ferrarini	Chairman of TLX S.p.A.; Director of Autostrade S.p.A.
Jean Paul Fitoussi	- - -
Enzo Grilli	Director of Generali S.p.A.
Gianni Mion	Managing Director of Edizione Holding S.p.A.; Director of Autogrill S.p.A., Autostrade S.p.A., Benetton Group S.p.A., Cartiere Burgo S.p.A., Luxottica Group S.p.A., Olimpia S.p.A., Schemaventotto S.p.A. and 21Investimenti S.p.A.
Massimo Moratti	Director of Interbanca S.p.A. and Pirelli & C. S.p.A.
Marco Onado	Chairman of Pioneer Global Asset Management S.p.A.
Renato Pagliaro	Director of Cartiere Burgo S.p.A. and RCS Mediagroup S.p.A.; Co-General Manager of Mediobanca S.p.A.

Pasquale Pistorio	Honorary Chairman of STMicroelectronics S.p.A.; Director of Fiat S.p.A.
Carlo Alessandro Puri Negri	Deputy Chairman and Managing Director of Pirelli & C. Real Estate S.p.A.; Deputy Chairman of Camfin S.p.A. and Pirelli & C. S.p.A.; Director of Capitalia S.p.A. and Olimpia S.p.A.
Luigi Roth	Chairman of Fondazione Fiera di Milano and Terna S.p.A.; Deputy Chairman of Cassa Depositi e Prestiti S.p.A.

The directors Francesco Denozza, Guido Ferrarini, Jean Paul Fitoussi and Pasquale Pistorio were elected from the slate presented by the group of institutional investors and the others from the slate presented by Olimpia S.p.A., which at present holds approximately 18% of the ordinary share capital.

Board performance evaluation

In 2005, for the first time, **the directors carried out a Board performance evaluation**, in line with international best practice. The evaluation (carried out through the use of specific questionnaires) permitted two objectives to be pursued: on the one hand to check the working of the Board as a whole and on the other to assess the contributions to its activity and the conduct of the executive directors, the non-executive directors and the independent directors.

The analysis of the responses to the questionnaires revealed a generally positive assessment of the Board and its members but also some aspects susceptible to improvement. This permitted the identification of measures to make the organization of the Board more efficient and enhance its effectiveness, basically by increasing the involvement of the Board as a whole in issues addressed in a specialist manner by Board committees and organizing structured meetings with the management, with a consequent heightening of individual directors' appreciation of the matters of interest to the Company.

Independent directors

In conformity with international best practice and the recommendations of the Italian corporate governance code, known as the Preda Code, Telecom Italia has laid down a set of principles by means of which to establish directors' independence. According to the Board of Directors' annual assessment of the declarations submitted by the directors concerned, **at present 11 of the 19 members of the Board qualify as independent**, namely: Paolo Baratta, John Robert Sotheby Boas, Domenico De Sole, Francesco Denozza, Luigi Fausti, Guido Ferrarini, Jean Paul Fitoussi, Enzo Grilli, Marco Onado, Pasquale Pistorio and Luigi Roth. The composition of the Board also complies with the recently adopted law on the protection of savings, according to which at least one director must satisfy the independence requirements for the members of the Board of Auditors laid down in Legislative Decree 58/1998, as amended by the law on the protection of savings.

Telecom Italia's Self-Regulatory Code (available on the Internet at www.telecomitalia.it under Investors/ Governance/ Codes, Principles and Procedures) defines independent directors **as those who neither have nor have recently had business dealings with Group companies or executive directors or members of their families on a scale able to influence their judgement and who are not in a position to exercise a significant influence over the Company** as a consequence of the shares they hold or their participation in shareholders' agreements. This requirement is

interpreted extensively, in order to assess “substantial” independence; accordingly, directors who have material dealings with natural or legal persons who are parties to a shareholders’ agreement do not qualify as independent.

In addition, since 2004 the Company’s Board of Directors has also had a **Lead Independent Director**, who is intended to provide a point of reference and coordination for the needs and inputs of the independent directors. At present the position is held by Professor Guido Ferrarini, Chairman of the Internal Control and Corporate Governance Committee.

Among other things, the Lead Independent Director is authorized to call, at his own initiative or at the request of other directors, special meetings of the independent directors (Independent Directors’ Executive Sessions) to discuss issues related to the working of the Board or the management of the business.

Five Independent Directors’ Executive Sessions were held in 2005; the main extraordinary corporate actions were examined as well as some issues concerning management remuneration and incentives. In accordance with international best practice, the independent directors also carried out a management evaluation, the results of which were shared with the other non-executive directors in a special executive session of the Board. The overall assessment was positive: in a context marked by fast-changing strategic scenarios, technologies and markets, Telecom Italia’s management had shown itself to be aware of the scale and rapidity of the transformation under way and of the dangers (but also the opportunities) for the Group. In particular, it had identified the strategy of convergence as the means of creating a long-term competitive advantage and achieving the growth and earnings objectives, notwithstanding the increasing pressure on market shares and prices.

Executive directors

The authority to grant delegated powers to directors and revoke such mandates is reserved to the Board of Directors, which also establishes their objects and limits, their duration and the intervals at which persons with delegated powers must report on their activity, the general results of operations, and the transactions of greatest economic, financial or balance sheet significance concluded by the Company or its subsidiaries.

In 2004 the Board of Directors appointed Marco Tronchetti Provera as Chairman and Carlo Orazio Buora and Riccardo Ruggiero as Managing Directors; Gilberto Benetton was made Deputy Chairman. Following the merger with Tim and until the adoption of the One Company Model, from July to October Marco De Benedetti was also a Managing Director.

Despite the broad scope of the mandates granted to the executive directors, the power to take decisions on transactions of particular significance continues to be exercised by the Board as a whole, even when they are theoretically within the limits of the executive directors’ mandates. This is because **delegating powers is not considered a way of attributing exclusive competences** but as a means of ensuring, from the standpoint of organizing the management function, the greatest possible operational flexibility, both within the Company and in relation to third parties. During the year this concept was taken a step further by reclassifying what had originally been defined as substantial limits (in terms of eligible transactions and amounts) as mere **internal limits to the relationship of trust between the Board that delegates powers and the persons who exercise them**. In fact the Chairman and the Managing Directors are all **legal representatives of the Company and they are individually authorized to carry out any transaction relating to the Company’s activity**.

On 5 October 2005, consistently with the adoption of the **One Company Model**, **responsibility for the development of fixed, mobile and Internet services was assigned to the same person**. This

provides for the **unitary direction of the business** in addition to the **unitary direction of corporate affairs**. The consequent allocation of functions and related organizational responsibilities is set out below:

- Riccardo Ruggiero, **Managing Director**, is responsible for operations from the standpoint of the management and development of the business;
- Carlo Buora, **Managing Director**, is responsible for the guidance and control of the business and for matters of a transversal nature affecting the entire business;
- Marco Tronchetti Provera, **Chairman**, is entrusted with coordinating the activity of the two Managing Directors and with establishing, together with them, the strategic guidelines for the Group and its development, with direct responsibility for the following areas: institutional affairs, communications and image, and investor relations.

As regards **the reports** the Chairman and the Managing Directors are required to make to the Board of Directors and the Board of Auditors, the Company has adopted procedures formalizing the rules and methods for gathering and transmitting information on their activity, transactions with major implications for the profitability, financial position and/or assets and liabilities of the Company and the Group, transactions with related parties (including intra-group business) and atypical or unusual transactions.

Directors' remuneration

The shareholders' meeting of 7 April 2005, after voting to increase the number of directors on the Board from 19 to 21 and in accordance with the first paragraph of Article 2389 of the Civil Code, augmented the maximum total annual remuneration of the Board for the second and third years of its mandate, from €2,700,000 to €3,000,000. It left the method of allocating this amount unchanged:

- €114,000 to be paid to each director in office;
- an additional €63,000 to be paid to each of the four members of the Internal Control and Corporate Governance Committee (Guido Ferrarini, Francesco Denozza, Domenico De Sole and Marco Onado);
- an additional €52,000 to be paid to each of the three members of the Remuneration Committee (Luigi Fausti, Paolo Baratta and Pasquale Pistorio);
- an additional €20,000 to be paid to each of the three members of the Strategy Committee other than the Chairman of the Board and the Managing Director Carlo Buora (Domenico De Sole, Marco Onado and Pasquale Pistorio);
- an additional €20,000 to be paid to the director appointed to the Supervisory Panel set up under Legislative Decree 231/2001 (Guido Ferrarini).

Set up in 2000, the Board's **Remuneration Committee consists exclusively of independent directors** and is charged with **fact-finding and advisory functions**. Since 6 May 2004 the membership has been as follows: Paolo Baratta, Pasquale Pistorio and Luigi Fausti, chairman. In 2005 the Committee met **three** times; the average attendance rate was approximately **90%**.

The Committee is charged with putting forward proposals with regard to the remuneration of the directors who hold particular offices and the criteria for the remuneration of the Company's senior management. Last year it also made an assessment of the appropriateness and effectiveness of the compensation and incentive schemes for managers and executive directors.

The current remuneration system for **executive directors** provides for them to receive a **fixed component and an additional payment subject to the achievement of the objective for**

consolidated EBIT with positive Delta EVA, in other words when value is created for all investors. **There is no provision for stock options for directors.**¹

Further information on the compensation paid to the executive directors can be found in the relevant table in the Notes to the financial statements.

The remuneration system for management provides performance and loyalty incentives on top of a basic salary. The incentives include both cash payments and stock options. Details on the latter are contained in the “Human resources” section of the Report on Operations.

THE INTERNAL CONTROL SYSTEM

The internal control system is one of the aspects of corporate governance to which Telecom Italia has devoted the most attention. It has developed as **a process** intended to achieve substantial and procedural fairness, **transparency** and **accountability, corner-stones of the Company’s entrepreneurial activity**, as laid down in the Group Code of Ethics. The aim of the process is to ensure that the management of the business is efficient and can be known and verified, that accounting and operational data are accurate, that applicable laws and regulations are complied with, and that the assets of the business are safeguarded, not least with a view to preventing fraud against the Company and financial markets.

The cardinal rules of the Company’s internal control system concern:

- **the separation of roles** in the performance of the principal activities involved in each operating process;
- **the traceability** and constant visibility **of decisions**;
- **decision-making on an objective basis.**

As the body responsible for the internal control system, the **Board of Directors** lays down the guidelines for the system and verifies that it is adequate and works effectively, making sure that the main corporate risks are appropriately identified and managed. To this end the Board uses the Internal Control and Corporate Governance Committee and a suitably independent person appointed to be responsible for internal control and endowed with sufficient resources to perform the function.

The Managing Director Carlo Buora is charged with the task of determining the mechanisms of the system and the manner in which it is to be implemented in accordance with the guidelines established by the Board; he is also responsible for ensuring the system’s overall adequacy, its effectiveness and its adaptation to changes in operating conditions and the legislative and regulatory framework.

The basic functions assigned to the person responsible for internal control are to verify the adequacy and effectiveness of the system and, where anomalies are found, to propose appropriate remedies. The Board has appointed the Company’s internal auditor (Telecom Italia Audit), in the person of the director assigned to the task, to be responsible for its internal control system. The person responsible for internal control reports on its activity to the Internal Control and Corporate Governance Committee and the Board of Auditors.

Any maintenance work on the internal control system is performed by the competent sectors of the Company or Group companies. In order to ensure the implementation of improvements to the internal control system and foster the dissemination of a methodology and culture of governance and risk management, managers of particular standing and authority within the organization are appointed as **“persons responsible for implementation”**. In order to improve the deployment of the Group

¹ The Managing Director Riccardo Ruggiero is an exception in this respect since, prior to his being co-opted to the Board of Directors, as General Manager he was among the beneficiaries of a stock-option plan. N. B.

internal control system, in 2005 the position of Group Compliance Officer was created to ensure the overall coordination of the various implementation plans and thus guarantee, with the assistance of Telecom Italia Audit, methodological correctness in the management of risk. To further strengthen the system, the persons responsible for implementation have been flanked by compliance managers coordinated by the Group Compliance Officer.

As mentioned earlier, **internal auditing** has been entrusted to the **consortium company Telecom Italia Audit**, in which TI Media also holds an interest, with the aim of maximizing the independence of the person responsible for internal control from Telecom Italia's corporate structures, with respect to which the audit function is completely autonomous.

As regards compliance with the provisions implementing the Sarbanes-Oxley Act, last year saw further progress in carrying out **Project 404**, which involves the whole Group and, under the guidance of the related Steering Committee, is intended to equip the Company with the most suitable instruments to ensure timely compliance with the attestation requirements introduced by Section 404 of the Act with regard to the **internal control system and procedures for financial reporting, requirements** to which Telecom Italia will be subject as of its annual report for 2006.

The Company's internal control system is completed by the so-called **231 Organizational Model**, which goes beyond the mere application of the provisions of Legislative Decree 231/2001, since it provides a paradigm for the conduct of all those who act in the Company's name and on its behalf. More specifically, the model comprises "principles for dealings with governmental bodies" (elaborated as a set of rules for relations with representatives of such bodies) and "internal control checklists" (i) listing the main stages of every process, (ii) the offences that may be committed in relation to individual processes, and (iii) the control activities to prevent the related risks from arising.

The organizational model is reviewed periodically in the light of experience in its application and changes to the law subsequent to the initial framework created by Legislative Decree 231/2001, including the broadening of its scope to encompass other cases. In 2005 the Company verified, in accordance with the discipline established by Legislative Decree 231/2001, the adequacy of the internal control system with respect to the new types of offence considered, with special reference to violations of company law. For the most part the results of the checks were satisfactory; for cases that were not fully regulated the 231 Organizational Model was supplemented as necessary with the adoption of some new internal control checklists for operational and instrumental processes exposed to the risk of offences being committed. At present the model is being fine tuned to incorporate the risks associated with the legislation on market abuse.

Monitoring of the functioning and compliance with the model is performed by a **Supervisory Panel** made up of a member of the Board of Auditors (Ferdinando Superti Furga, chairman), an independent director on the Internal Control and Corporate Governance Committee (Guido Ferrarini) and the person responsible for the internal control system. This ensures that the members of the Panel embody all the professional skills involved in the control of the Company's operations.

The Supervisory Panel will encourage the Board of Directors to adapt the model as needed to changes in the legislative and regulatory framework, the nature of the Company's business activities and the ways they are conducted. It reports to the Board of Directors, the Internal Control and Corporate Governance Committee and the Board of Auditors on the checks performed and their results.

The shareholders' meeting of 6 May 2004 resolved that the member of the Board of Auditors serving on the Supervisory Panel should be paid a gross annual fee of €20,000, the same as that assigned by the Board of Directors to the member of the Internal Control and Corporate Governance Committee serving on the Panel.

Lastly, it should be noted that a special unit (the 231 Support Group) has been created within Telecom Italia Audit to provide operational support to the Supervisory Panels of Group companies by handling reports of violations of the organizational model and conducting compliance audits on the basis of the data received by way of the information flows that have been put in place.

The Internal Control and Corporate Governance Committee

Since 2000 the Board of Directors of Telecom Italia has had an Internal Control and Corporate Governance Committee, charged with **advisory functions and the formulation of proposals**. In particular the Committee:

- evaluates the adequacy of the internal control system;
- evaluates the work plan prepared by the person responsible for internal control, from whom it receives periodic reports;
- assesses, together with the heads of the Company's administrative departments and the external auditors, whether the accounting policies have been correctly applied and are homogeneous for the purpose of preparing the consolidated financial statements;
- evaluates the proposals made by the external auditors in order to be awarded the appointment, the audit plan and the results set out in the letter of suggestions;
- reports to the Board of Directors on the activity performed and the adequacy of the internal control system;
- performs the additional tasks that may be assigned to it by the Board of Directors, particularly as regards relations with the external auditors; and
- monitors compliance with the rules of corporate governance and their periodic updating.

The Committee is composed entirely of independent directors, in its meeting on 6 May 2004 the Board of Directors appointed Francesco Denozza, Domenico De Sole, Marco Onado and Guido Ferrarini (Chairman).

In 2005 the Committee met **eleven** times; attendance at the meetings was **100 per cent**. Committee meetings are also attended by the Chairman of the Board of Auditors or by the auditor he designates. Where it is deemed desirable in the light of the issues on the agenda, the Committee and the Board of Auditors may hold joint meetings.

During the year the Committee contributed to the **implementation of the Company's instruments of corporate governance** and participated in the process of analyzing, specifying and updating them. It **also played an active role in the integration of Telecom Italia and Tim, verifying the procedural correctness of valuations and the fairness of the operation**. It examined the plan for the restructuring of the Group, with special reference to the merger of Tim into Telecom Italia and the concentration of the Group's Internet operations in the parent company. In addition, it analyzed the application of IAS/IFRS to the financial statements and kept abreast of the progress made by Project 404.

As well as monitoring transactions that the Board deemed to be especially delicate, the Committee examined and approved the basic elements of the internal audit plan for 2006 and the quarterly plans of the person responsible for internal control. It periodically assessed the work of Telecom Italia Audit, paying particular attention to the company's report on internal auditing activity in 2005 and the checks it performed, and the progress made by the Group projects known as Control Risk Self-Assessment and Check-Up of Administrative Systems.

Lastly, the Committee discussed the plan for the 2006 statutory audits with representatives of the external auditors, Reconta Ernst & Young.

THE STRATEGY COMMITTEE

Since 2004 the Board of Directors of Telecom Italia has had a Strategy Committee to **increase the involvement of the Board in the Company's strategic decision-making**, especially as regards guiding the evolutionary processes under way in the Group's business in the light of the rapid transformation of technologies and markets.

The Strategy Committee consists of the Chairman of the Board (who ensures the alignment and coordination of the activities of the Committee, the Board and management), the Managing Director charged with ensuring the guidance and control of the business (Carlo Buora), and three independent directors (Domenico De Sole, Marco Onado and Pasquale Pistorio) specialized in the fields of technology, organizational strategies and corporate finance.

The Committee is entrusted with the task of **assisting the Board of Directors in making strategic choices in the light of competitive developments**, with special reference to decisions concerning:

- the potential evolution of the structure of the telecommunications industry;
- the strategic positioning and business models of the Group;
- the evolution of the Group's organization in relation to its business models;
- the evolution of the Group's corporate and financial structure;
- the monitoring of the stage reached in the process of change.

In addition to calling on the heads of units within the Company, the Committee may employ consultants and external experts.

The Committee met **four** times in 2005, generally at the same time as a meeting of the Board of Directors and with an attendance rate of **95%**. The meetings were attended by managers of the Group, invited according to their specific expertise to provide inputs with regard to the matters on the agenda. The Committee **examined and produced recommendations on the following subjects**:

- **Market scenarios**: technological trends, evolution of consumption patterns, convergence initiatives by the main telecommunications operators – analysis of regulatory frameworks and the strategy and positioning of the Group with regard to telecommunications and, more generally, to information and communication technology (ICT).
- **Internet**: plans for the integration of platforms and business models (Tin.it, Virgilio and Rosso Alice).
- **Sharpening the focus of the business**.
- **Strategic projects and international positioning**: Europe, Mediterranean basin, Latin America.
- **Integrated organizational model**: basic principles, business objectives and the One Company Model.

BOARD OF AUDITORS

The Company's Board of Auditors took office in May 2003 and consists of five auditors: Ferdinando Superti Furga (Chairman), Salvatore Spiniello and Gianfranco Zanda (elected from the slate presented by Olimpia) and Rosalba Casiraghi and Paolo Golia (elected from the slate presented by institutional investors).

The offices held by the members of the board of auditors in other listed companies are shown below:

Ferdinando Superti Furga	Director of Parmalat S.p.A. and Risanamento S.p.A.; member of the board of auditors of Arnoldo Mondadori Editore S.p.A. and Edison S.p.A.
Rosalba Casiraghi	Member of the board of auditors of Banca Intesa S.p.A.
Paolo Golia	---
Salvatore Spiniello	Director of Fondiaria Sai S.p.A. and Immobiliare Lombarda S.p.A.; member of the board of auditors of Edison S.p.A. and Telecom Italia Media S.p.A.
Gianfranco Zanda	---

The Board of Auditors **plays a key role in the Company's system of corporate governance**. In addition to the **fifteen** meetings it held during the year (some jointly with the Internal Control and Corporate Governance Committee and with an attendance rate of **96%**), its members participated in the eleven meetings of the Board of Directors and periodically received the reports submitted by the bodies with delegated powers, as provided for in the relevant procedure.

The importance of the Board of Auditors is confirmed by the choices made with regard to US company law. Specifically, under the applicable provisions, **the existence of the Board of Auditors makes it unnecessary for the Company to set up a separate Audit Committee**.

In view of the requirement that the Audit Committee approve all the services the auditing firm (and associated persons) supply to the issuer and its directly and indirectly controlled subsidiaries, the Company has adopted a **Group Procedure for the Appointment of Auditors**. In particular, this provides on a general basis for the centralized control of relations with auditing firms to prevent engagements for non-audit services being granted that fail to comply with the applicable Italian or US law and that ultimately could undermine auditor independence. The procedure (which appears to be consistent with the requirements introduced by the new law on the protection of savings) regulates the engagement of auditing firms and persons associated with them on a continuous basis, distinguishing between engagements that must be individually authorized in advance by the Board of Auditors and those falling within categories subject to a generic authorization. The procedure significantly restricts the power of the Board of Directors (and the management) while enhancing the independent control function performed by the Board of Auditors.

The Company has also adopted the principle of employing the same auditing firm throughout the Group; in fact the appointment of other firms must be agreed in advance with the parent company following a reasoned request on which Telecom Italia's Board of Auditors gives its opinion on the basis of inquiries made by the person responsible for internal control.

In order to make available the broad range of information needed by the Board of Auditors to perform its control function effectively, a procedure has been put in place, as mentioned earlier, for the collection and transmission to the members of the Board of Auditors (and the directors) of information on: the activity carried out by the Company; the transactions of greatest significance for the Company's profitability, financial position and assets and liabilities; transactions with related parties (including intra-group transactions); and atypical and unusual transactions.

The above-mentioned procedures are available on the Company's website under Investors/Governance.

In view of its responsibilities under Italian law and the obligations deriving from US law, in 2005 the Board of Auditors adopted a procedure for receiving, retaining and treating the reports it receives. Such reports can be of the following kinds:

- statements of violations submitted by shareholders concerning matters deemed to be censurable;

- complaints by any person, thus including non-shareholders, concerning alleged irregularities, censurable facts or, more generally, any problem or issue deemed to merit investigation by the control body;
- complaints specifically regarding accounting, internal accounting controls, or auditing matters;
- confidential, anonymous submissions of “concerns” by employees of the Company or the Group regarding questionable accounting or auditing matters.

A short description of how such reports are to be submitted to the Board of Auditors/Audit Committee is available on the Company’s website under Investors/ Governance.

In addition to the tasks performed in its Audit Committee capacity, the Board of Auditors carried out **supervisory functions** provided for under Italian law: verifying that the transactions of greatest significance for the Company’s profitability, financial position and assets and liabilities conformed with the law, the bylaws and the principles of correct management; checking that transactions with related parties complied with the self-regulatory principles and procedures adopted by the Company and that they were in its interest; and checking the adequacy of the organizational structure. The Board of Auditors also **monitored the adequacy of the internal control system and that of the administrative and accounting system and the latter’s reliability in correctly representing transactions**. Lastly, it investigated the reports it received under Article 2408 of the Civil Code and the complaints submitted to it during the year, as described in its report to the shareholders’ meeting. More detailed information on the activity of the Board of Auditors can be found in its report pursuant to Article 153 of Legislative Decree 58/1998, which is included in the 2005 Annual Report.

SHAREHOLDERS’ MEETINGS

Ordinary and extraordinary shareholders’ meetings were held on 7 April 2005. In the extraordinary meeting the shareholders approved the plan for the merger of Telecom Italia Media S.p.A. into Telecom Italia S.p.A. and approved the consequent amendments to Article 5 of the bylaws (under the heading Share Capital – Shares – Bonds). In the ordinary meeting, in addition to approving the annual report for 2004, the shareholders brought the Board of the “new” Telecom Italia up to full strength following approval of the merger plan by appointing Marco De Benedetti and Enzo Grilli as directors [see the “Appointment of directors” section of this corporate governance report]. At the same time, in accordance with Article 2389 of the Civil Code, the meeting augmented the maximum total annual remuneration of the Board from €2.7 million to €3 million [see the “Directors’ remuneration” section of this corporate governance report].

As usual, the Company sought to increase shareholders’ attendance at the meetings by providing the documents needed for informed participation to all those who requested them and, as provided for in the bylaws, ordinary shareholders were able to **vote by mail**.

Furthermore, pursuant to the bylaws, the Company made special areas available to associations of employee shareholders in which to provide information and collect proxy forms.

CODE OF ETHICS

The Code of Ethics of the Telecom Italia Group can be considered as lying upstream from the whole system of corporate governance and as enshrining the set of fundamental values and principles that serve to ensure an ethically-oriented conduct of business. The Code, which has gradually been

adopted by all the companies belonging to the Group, specifies the objectives to be aimed at and the values to be fostered in relation to all the main stakeholders Telecom Italia interacts with every day: shareholders, financial markets, customers, local communities and employees.

Like all the Company's other instruments of corporate governance, the Group Code of Ethics is **continuously reviewed in the light of developments in the applicable law** and operational and market practices, and with consideration also given to the results of the monitoring of units' compliance by the person responsible for internal control. The present version of the Code takes account of the requirements of the US discipline, primarily as regards the Code of Ethics referred to in the Sarbanes-Oxley Act and the Code of Conduct required by the listing standards of the New York Stock Exchange, which make it mandatory to have a code of conduct for certain categories of officers (executives and financial and accounting officers).

The Company's other governance documents are tied in with the Group Code of Ethics and thus increasingly enhance the importance of its role at the **centre of the internal control system**.

The Code is available on the Company's website, together with the other governance documents referred to, under Investors/ Governance.

RULES OF CONDUCT FOR TRANSACTIONS WITH RELATED PARTIES

In 2002 the Company adopted guidelines (available on the Company's website under Investors/ Governance) for carrying out transactions with related parties. They are **intended to ensure both procedural and substantial fairness and transparency by entrusting the related decisions** to the Board of Directors.

In fact **the Board of Directors is required to give advance approval to transactions with related parties, including intra-group transactions, apart from those of a customary nature to be concluded at standard conditions**. To this end, provision is made for the Board to be adequately informed of all the relevant aspects: the nature of the relationship, the manner of carrying out the transaction, the economic and other conditions, the evaluation procedures used, the rationale for the transaction, the Company's interest in its implementation and the associated risks. Moreover, if the related party is a director or a party related via a director, he or she may only provide clarifications and must leave the meeting when the motion is examined and put to a vote. Depending on the nature, value and other aspects of related-party transactions, the Board may be assisted by outside experts in order to prevent contracts being concluded at inappropriate conditions.

The rules are consistent with the legal framework established by the reform of company law known as the Vietti reform and in 2006, despite Consob not having issued the indications provided for, were supplemented by a **procedure designed** to provide an objective basis for the treatment of concrete situations. Before any transaction is carried out, it will be necessary to consult an expert system (appropriately interfaced with a database that is being added to as the system is deployed) that will automatically provide – on the basis of information gathered using ad hoc checklists – indications concerning decision-making powers, internal information flows for reporting purposes, and the need for an external opinion in evaluating the congruousness of transactions.

More detailed information on transactions with related parties can be found in the Company's Report on Operations in the section "Related party transactions". In this respect it should be noted that on two occasions the Board of Directors exonerated directors who were related to the counterparty of the transaction on the agenda from leaving the meeting since a discussion was not considered necessary in light of the information received in preparation for the meetings.

MANAGEMENT OF INFORMATION

Transparent relations with the market and the provision of accurate, clear and complete information are standards for the conduct of the members of the governing bodies, the management and all the employees of the Telecom Italia Group.

Confidential information is dealt with by the Chairman of the Board of Directors on the basis of procedures for the internal processing and disclosure to third parties of documents and information concerning the Company. **The procedure for disclosing price-sensitive information was replaced in 2006 by a more general procedure for the disclosure of inside information, which takes account of the legislation on market abuse and provides for the creation, with effect from 1 April 2006, of a register of persons with access to inside information.**

The adoption of the new procedure is the most tangible result of the activity of the working group the Company set up to evaluate the effects of the transposition into Italian law of the Market Abuse Directive (Community Law 2004).

The decision to set up the working group was taken at the initiative of the Disclosure Committee, a body made up of managers that provides assistance to the Board of Directors and top management on the processing and handling of the data and news necessary for correct disclosure. The Committee is charged with assisting in the preparation and checking of periodic financial reports, prospectuses and corporate disclosures in general. The role and operating rules of the Disclosure Committee are likely to be revised in the process of adapting the Company's system of corporate governance to the requirements of the recent law on the protection of savings (including the introduction of the "manager responsible for preparing the Company's financial reports").

The Disclosure Committee Rules are posted on the Company's website under Investors/ Governance.

CODE OF CONDUCT ON INSIDER DEALING

The Company's **Code of Conduct** on Insider Dealing, adopted in December 2002 and laying down the rules of conduct and the disclosure requirements applicable **to transactions involving financial instruments issued by Group companies carried out by persons who have access to material information as a consequence of their positions** will be superseded, as of 1 April 2006, with the entry into force of a Consob regulation issued pursuant to Legislative Decree 58/1998, as amended by the law on market abuse.

The law imposes a disclosure obligation for so-called insider-dealing transactions on, among others, the directors and members of the board of auditors of a listed company and "persons performing administrative, supervisory and management functions in a listed issuer and managers who have regular access to inside information and the power to make managerial decisions affecting the future development and prospects of the issuer". Telecom Italia has chosen to identify such persons in the key managers referred to in IAS/IFRS 24 and in executive officers for the purposes of US applicable law.

In 2005 the Company made 10 filings in accordance with Article 2.6.4 of Borsa Italiana's Market Rules. These filings can be found on the Company's website under Investors/ Governance.

MEETING REGULATIONS

As provided for in the bylaws, the shareholders' meeting has approved a set of regulations for shareholders' meetings.

The document also contains the procedure for ordinary shareholders to vote by mail, as provided for in the bylaws, so as to ensure the fullest possible **guidance on the organizational and procedural aspects** of this important moment in shareholders' participation in the life of the Company.

The Meeting Regulations are available on the Company's website, under Investors/ Governance.

INVESTOR RELATIONS

A special unit, headed by the Chairman, is responsible for handling relations with the financial community in Italy and abroad. In 2006 the scope of the unit's activity was extended to include retail investors.

More detailed information can be found in this report in the section "Financial communications".

Additional information can be obtained from the following addresses:

Institutional investors:

Telecom Italia S.p.A.

Investor Relations

Piazza degli Affari, 2

20123 Milan

Tel.: +39 02 8595 4131

E-mail: investor_relations@telecomitalia.it

Retail investors:

Telecom Italia S.p.A.

Investor Relations

Piazza degli Affari, 2

20123 Milan

Tel.: +39 02 8595 4131

E-mail: investitori.individuali@telecomitalia.it

SHAREHOLDERS' AGREEMENTS

At 31 December 2005 the largest shareholder of Telecom Italia was still Olimpia S.p.A., with approximately 18% of the ordinary share capital (2,407 million ordinary shares).

The shareholders of Olimpia S.p.A. have concluded a number of shareholders' agreements; notices containing extracts of the following have been published in the Italian press:

- agreement between Pirelli & C. S.p.A. (formerly Pirelli S.p.A.) and Edizione Holding S.p.A. – Edizione Finance International S.A., concluded on 7 August 2001 and subsequently amended;
- agreement between Pirelli & C. S.p.A. (formerly Pirelli S.p.A.), Unicredito Italiano S.p.A. and Banca Intesa S.p.A., concluded on 14 September 2001 and subsequently amended;

- agreement between Pirelli & C. S.p.A. (formerly Pirelli S.p.A.), Banca Intesa S.p.A., Unicredito Italiano S.p.A., Edizione Holding S.p.A. – Edizione Finance International S.A., Hopa S.p.A. and Olimpia S.p.A. concluded on 21 February 2003 and subsequently amended. On 14 February 2006 a notice was published announcing the notification to Hopa S.p.A. of the withdrawal from the agreement of Pirelli & C. S.p.A., Banca Intesa S.p.A., Unicredito Italiano S.p.A., Edizione Holding S.p.A. – Edizione Finance International S.A. and Olimpia S.p.A., effective 8 May 2006.

The shareholders of Olimpia S.p.A. are currently Pirelli & C. S.p.A. (57.66%), Edizione Finance International S.A. (8.4%), Edizione Holding S.p.A. (8,4%), Hopa S.p.A. (16%), Unicredito Italiano S.p.A. (4.77%) and Banca Intesa S.p.A. (4.77%).

ASSESSMENT BY STANDARD & POOR'S

Telecom Italia considered it desirable to have its corporate governance system **assessed independently by Standard & Poor's**. Upon completion of the analysis, the Company was assigned an overall corporate governance score of 7+, the highest ever published by an Italian company.

The rating company recognized that Telecom Italia had progressively created a solid system of governance and strengthened the **independence and effectiveness of the Board of Directors**, which, with a majority of independent directors, stands out with respect to the majority of Italian listed companies by providing a forum for discussion and effective supervision of management.

In its report Standard & Poor's also noted that Telecom Italia's corporate governance system was marked by a high level of transparency and disclosure, combined with strong internal controls and effective supervision of the audit process provided by both the Board of Auditors and the Internal Control and Corporate Governance Committee.

TABLE 1: BOARD OF DIRECTORS AND BOARD COMMITTEES

Board of Directors							Internal Control Committee (i)		Remuneration Committee (ii)	
Position	Name	Executive director	Non-executive director	Independent director	****	Number of other positions held **	***	****	***	****
Chairman	Marco Tronchetti Provera	X			100%	6				
Deputy Chairman	Gilberto Benetton		X		91%	9				
Managing Director	Carlo Orazio Buora	X			82%	6				
Managing Director and General Manager	Riccardo Ruggiero	X			100%	1				
Managing Director	Marco De Benedetti ²	X			100%	---				
Director	Paolo Baratta		X	X	100%	2			X	100%
Director	John Robert Sotheby Boas		X	X	91%	---				
Director	Giovanni Consorte ³		X		64%	---				
Director	Domenico De Sole		X	X	100%	2	X	100%		
Director	Francesco Denozza *		X	X	100%	2	X	100%		
Director	Luigi Fausti		X	X	100%	2			X	100%
Director	Guido Ferrarini *		X	X	100%	2	X	100%		
Director	Jean Paul Fitoussi *		X	X	91%	---				
Director	Enzo Romano Grilli ⁴		X	X	88%	1				
Director	Gianni Mion		X		45%	9				
Director	Massimo Moratti		X		55%	2				
Director	Marco Onado		X	X	91%	1	X	100%		
Director	Renato Pagliaro		X		82%	3				

² Mr. De Benedetti was in office from April 7, 2005 until October 5, 2005; he was appointed Chief Executive Officer on July 26, 2005.

³ He resigned from the office on January 23, 2006

⁴ He was appointed Director on April 7, 2005, being identified as an Independent Director

Board of Directors							Internal Control Committee (i)		Remuneration Committee (ii)	
Position	Name	Executive director	Non-executive director	Independent director	****	Number of other positions held **	***	****	***	****
Director	Pasquale Pistorio *		X	X	91%	2			X	67%
Director	Carlo A. Puri Negri		X		91%	6				
Director	Luigi Roth		X	X	91%	3				
<p>(i) The Preda Code recommends that the Internal Control Committee should consist of non-executive directors, of whom the majority should be independent. Telecom Italia has gone further by establishing in its Self-Regulatory Code that the Committee for Internal Control and Corporate Governance is to consist exclusively of independent directors, of whom at least one elected from a slate presented by minority shareholders in accordance with the bylaws.</p> <p>(ii) Whereas the Preda Code recommends that the Remuneration Committee should consist prevalently of non-executive directors, in its Self-Regulatory Code Telecom Italia has gone further by providing for it to consist exclusively of non-executive directors, of whom at least one elected from a slate presented by minority shareholders in accordance with the bylaws</p>										
Number of meetings held during the year under review		Board of Directors: 11			Internal Control Committee: 11		Remuneration Committee: 3			

NOTES

* Directors elected from minority slates.

** Number of other financial, banking and insurance companies listed on regulated markets in Italy or abroad of which the director is a member of the board of directors or the board of auditors. The Corporate Governance Report provides details on the positions held.

*** The director is a member of this Committee.

**** The director's attendance at meetings of the board of directors or the board committee in question, as a percentage of the meetings held.

TABLE 2: BOARD OF AUDITORS

Position	Name	Attendance, as a percentage of the meetings held	Number of other positions held **
Chairman	Ferdinando Superti Furga	100%	4
Auditor	Rosalba Casiraghi *	93%	1
Auditor	Paolo Golia *	100%	---
Auditor	Salvatore Spiniello	93%	4
Auditor	Gianfranco Zanda	93%	---
Alternate	Enrico Maria Bignami *	=	=
Alternate	Enrico Laghi	=	=
Number of meetings held during the period under review: 15			
Quorum for minority shareholders to present a slate for the election of one or more auditors : 1%			

NOTES

* Elected from a minority slate.

** Number of other companies listed on regulated markets in Italy of which the auditor is a member of the board of directors or the board of auditors. The Corporate Governance Report provides details on the positions held.

TABLE 3: OTHER CORPORATE GOVERNANCE CODE PROVISIONS

	YES	NO	Summary explanation in the case of non-compliance with Code provisions
Delegations of authority and transactions involving related parties			
Has the board of directors delegated authority and defined:			
a) limits applicable thereto?	X		
b) manners of exercise applicable thereto?	X		
c) reporting frequency applicable thereto?	X		
Has the board of directors retained the power to review and approve transactions of particular significance for the company's profitability, assets and liabilities or financial position (with special reference to transactions involving related parties)?	X		
Has the board of directors defined guidelines and criteria for the identification of "transactions of particular significance"?	X		
Are these guidelines and criteria described in the Report?	X		
Has the board of directors defined procedures for the review and approval of transactions involving related parties?	X		
Are the procedures for approval of transactions involving related parties described in the Report?	X		
Procedures followed for the most recent appointments to the board (may 6 2004) of directors and the board of auditors (may 26 2003)			
Were the proposals for the appointment to the position of director deposited at the company's offices at least 10 days ahead of time?	X		
Were these proposals accompanied by detailed information?	X		
Did these proposals provide information on candidates' eligibility to qualify as independent directors?	X		

	YES	NO	Summary explanation in the case of non-compliance with Code provisions
Were the proposals for the appointment to the position of member of the board of auditors deposited at the company's offices at least 10 days ahead of time?	X		
Were these proposals accompanied by detailed information?	X		
Shareholders' Meetings			
Has the company adopted rules of procedure for its shareholders' meetings?	X		
Are these rules of procedure attached to the report (or does the report indicate where such rules can be obtained/downloaded?)	X		
Internal Controls			
Has the company appointed persons to run its internal control system?	X		
Are these persons not placed hierarchically under managers in charge of business units or operations?	X		
Unit in charge of internal controls (under Article 9.3 of the Code)			Telecom Italia, since 2002, has appointed its internal auditor – Telecom Italia Audit in the person of the Chairman, Mr. Armando Focaroli – to run its internal control system. The functions assigned include verifying the adequacy and efficiency of the system and proposing solutions where anomalies are found.
Investor Relations			
Has the company appointed an individual in charge of Investor Relations?	X		
Unit and contact information (address/phone/fax/e-mail) for the company's Investor Relations person			<p>Institutional investors: Telecom Italia S.p.A. Investor Relations Piazza degli Affari, 2 20123 Milan Tel.: +39 02 8595 4131 E-mail: investor_relations@telecomitalia.it</p> <p>Individual investors: Telecom Italia S.p.A. Investor Relations Piazza degli Affari, 2 20123 Milan Tel.: +39 02 85954131 E-mail: investitori.istituzionali@telecomitalia.it</p>