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PENSION AWARENESS AND NATION-WIDE AUTO-ENROLMENT: THE ITALIAN EXPERIENCE

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Pension awareness and nation-wide auto-enrolment: the Italian experience

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Abstract

The paper discusses the Italian experience in developing its system of private, supplementary pensions, as a case study of the implementation of nation-wide auto-enrolment mechanisms; in the discussion, attention is devoted to pension awareness issues. Auto-enrolment (i.e. the automatic enrolment of workers in a private pension plan, with the individual allowed to opt out) can be seen as an effective means to increase participation in supplementary pension plans, as the process of raising pension awareness is slow, and mandatory participation may be distortive of individualsô preferences and politically unfeasible. The paper summarizes the reasons for the limited success of auto-enrolment in Italy. Besides the importance of country-specific structural issues, the need for an overall, coherent, pension strategy is underlined, together with a consistent use of the different policy instruments available: not only in order to achieve the desired membership targets, but also as a prerequisite for effective awareness campaigns and education efforts. In addition, the importance is emphasized of a balance of responsibilities between the individual, the State, and intermediate bodies (such as social partners), with appropriate default options that should back-up the individual when he/she is unable or unwilling to choose; default options are important not only because they gently force individuals to ñtakeò the right decisions, but also as complements to education and information efforts, because they convey information and advice in a simple and effective way.

[1] The opinions expressed in the paper are those of the author and should not be attributed to COVIP and/or OECD.

1. **Introduction**

Auto-enrolment (i.e. the automatic enrolment of workers in a private pension plan, with the individual allowed to opt out) is gaining popularity as a means to increase participation in supplementary, defined contribution, pension plans[2].

Exploiting peopleòs inertia and overcoming procrastination, auto-enrolment is seen as a nice middle course between fully voluntary arrangements, where individuals are often not able to take appropriate, informed decisions, and compulsory mechanisms, which in principle are distortive of individualsô preferences and may be politically unfeasible.

For individual pension funds, auto-enrolment has been applied for many years, and it is often encouraged by regulation (e.g. in the U.S.). More ambitiously, in a few countries policy-makers are considering to introduce auto-enrolment at nation-wide level. For example, the U.K. and Ireland are planning to introduce nation-wide auto-enrolment programs in the near future. Therefore, it is interesting to put attention on the experience of Italy, one of only two countries[3] that -to the knowledge of the author- have already introduced nation-wide auto-enrolment programs.

This paper starts in section 2 with background information about the development of the Italian private pension system, and in section 3 describes the way the auto-enrolment program was designed and implemented. The results in terms of membership are presented in section 4, while section 5 is devoted to a discussion of the factors that have led to the limited success of the program. Section 6 presents some evidence on the level of financial literacy and pension awareness of Italian workers, together with their relationship with pension fund membership. Section 7 draws conclusions and identifies issues that are worth considering in the implementation of future nation-wide, auto-enrolment programs.

2. **Historical background**

At the beginning of the nineties, the diffusion of supplementary pension funds in Italy was very limited: only about 700.000 members, or 3% of workers**,** were enrolled, mostly high salary workers (managers of large companies, financial sector employees). Indeed, the Italian public pensions (based on an earnings-related, pay-as-you-go system) were generous, and there was no perceived need for supplementary pension funds directed at all workers.

Still, demographic trends, public budget imbalances and the long-term slowdown of the Italian economy were making the path of public expenditure for pensions clearly unsustainable. With

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2 *Vice versa*, the logic of defined benefit plans is naturally linked to universal membership. It should also be noted that in this paper auto-enrolment is meant to be different from mandatory enrolment, where enrolment may also be automatic, but individuals are not allowed to opt out. Mandatory enrolment is in place in many countries.

3 New Zealand has also in place, since July 2007, an auto-enrolment program (*KiwiSaver)*; differently from the Italian case, automatic enrolment applies to all workers aged 18-64 every time they enter a new job. The program is seen as quite successful, as in June 2010 it already enrolled more than 1,5 million workers. For more information, see the New Zealandòs Government specialized website www.kiwisaver.govt.nz .

the constraints imposed by participation to the process of European monetary convergence and finally unification, from 1992 major reforms of public pensions were introduced, including (in 1995) the introduction of the so-called notional defined contribution system. The reforms stabilized the long term public expenditure on pensions; they also significantly reduced future benefits, albeit with a long transition phase.

As a result, the need for a diffusion of pension funds among all workers (and especially the young) became clear. In several stages from 1992-3, a comprehensive regulatory and supervisory framework for supplementary pension funds was introduced. Its main features included:

- an overarching favour for the regime of defined contribution, the only one admissible for new members and schemes instituted with the new legislation; the defined benefit regime could therefore survive only for the funds already in place before the reform, and only for the workers that were already enrolled in them[4];

- for the employed private-sector workers, a leading role assigned to ñcontractualò, usually industry-wide pension funds, set up trough labour agreements and governed as stand-alone, non-profit organizations by representatives of workers (*de facto* the trade unions) and employers[5] on a parity basis.

- voluntary membership for individual workers;

- in the case an employee decided to enrol, the obligation for the employer to pay in the pension fund the contribution rate set by labour agreements (usually around 1-1.5% of gross wages), with a matching contribution by the employee; in addition, the flow of TFR (*Trattamento di fine rapporto,* a sort of deferred salary)[6] would be also paid into the fund, in its entirety for new workers (those employed after the new legislation was introduced), and usually only partially for older workers (according to the relevant labour agreements).

- the possibility for financial institutions (banks, insurance companies, asset management companies) to set so-called ñopen pension fundsò, collective investment vehicles having an explicit retirement purpose and open in principle to all workers, although mainly directed to

[4] In principle, defined benefit funds dedicated to the self-employed would still allowed to be established; however, no fund of this kind has been instituted under the new legislation. Besides, in the case of severe technical imbalances, the old funds were allowed to apply for the authorization to continue to accept new members in the defined benefit regime; only three funds did apply and received the authorization.

[5] In practice, for employed workers, industry-wide funds instituted by national labour agreements were given, within their sector, a sort of monopoly vis-à-vis the so-called open pension funds (see infra).

[6] The flow of TFR (*Trattamento di fine rapporto*) is set by law at 6.91% of gross salary, net of a residual percentage that is not accrued in favour of the individual workers. The TFR is accrued by employers as a debt to their workers, and is paid at termination of employment. It carries an annual yield of 1.5 % plus ¾ of the inflation rate. Since the introduction of the new legislation, the TFR is the major source of financing of pension funds in Italy.

the self-employed and to workers employed in sectors where no ñincumbentò, contractual pension fund is instituted[7].

With the introduction of the new framework, the shift of responsibility and risks from the State to individual workers was significant. In the ñoldò system, pensions are calculated as a function of individual earnings, and are (in principle) independent both of future macroeconomic developments and the performance of financial markets. In the new system, the public, first pillar component is tied to the growth rate of the Italian economy, as well as to the development of life expectancy; the private, second (and third) pillar component is a direct function, besides of life expectancy, of the behaviour of financial markets, and of several decisions that the individual is asked to take regarding membership, choice of fund, contribution rates, investment options.

Overall, the risk that individuals are set to bear, in terms of a lower than expected replacement rate at retirement, have increased from almost nil to meaningful. Individualsô responsibility in taking appropriate decisions regarding their pensions has increased substantially.

Indeed, temporary mitigations of the shifting of responsibility to individuals were put in place. First, individual employees were in practice discouraged from opting out from their incumbent, contractual pension fund, by choosing an open pension fund: in doing so they would have lost the employerôs contributions and significant fiscal incentives. Second, for several years contractual pension funds offered only one investment line, and therefore no decision regarding investments was required to members. Members were anyway requested to make their choice regarding membership and, sometimes, contribution rates[8].

In terms of public policy, it would be expected that the introduction of the new system -with greatly increased responsibilities awarded to individuals- would have been accompanied by a significant effort to inform the population at large (and the more so the young, those most affected by the reforms), and to empower individuals to take informed decisions regarding their pensions.

In the years that followed the reform, these efforts were limited and uneven. There was no major, government-run, information campaign aimed at developing awareness about the decrease of public pensions; this issue was considered *per se* as politically tricky. Communication efforts did occur at the level of individual companies and sectors of the economy, by initiative of both employers and the trade unions, in connection with the institution of contractual pension funds. But there were large differences across funds, as a function of the characteristics of their industry: where the typical size of companies was large, the communication about the new system and the choices available to individual workers was often good, and the results in terms of membership followed; where the industry structure was highly

7 Later, in 2001, insurance-based individual plans (so-called PIPs) were introduced.

8 Other kinds of choices, such as that to be taken at retirement between an annuity or a lump-sum, are not discussed here.

fragmented and the productive units small, communication was poorer and membership rates stayed low.

In the aggregate, pension fund membership increased rapidly in the early years of the new system, when many contractual funds were launched, but slowed down since 2001, in particular for employed workers. At the end of 2003, pension fund members did not exceed 2,6 millions, about 12 per cent of the work force.

While the Italian pension fund system looked well-built in structural terms, it was clear that it needed a strong push, if it had to become an essential component of the Italian pension framework. More specifically, it became evident that relying on voluntary membership and on rising the awareness of the need for supplementary pensions was not going to increase membership as quickly as desired.

3. Nation-wide auto-enrolment: ñthe TFR reformò

In 2004-05, after a wide public debate, the automatic enrolment in private pension funds of all employed workers of the private sector was decided, together with further fiscal incentives; adjustments of public pension rules, aimed at postponing the retirement age and reducing expenditure, were also introduced[9].

The automatic enrolment would be based on the payment into the pension funds of the future flow of the TFR (the initiative has been often called ñthe TFR reformò). Individual workers would be given a period of six months in order to decide whether to refuse this arrangement (and consequently the automatic enrolment with the pension funds); in this case, they would keep their rights regarding the TFR as in the past. For the future, the same mechanism would apply to all first-time employees, with their period of six months starting together with their first job. The pension fund receiving the TFR was generally indicated by labour agreements[10].

As the TFR had been serving until then not only as deferred salary for the employees, but also as a source of cheap financing for the employers, measures were envisaged (based on public guarantees) in order to ensure that additional banking loans would be made available for firms at a low cost.

As regards the ñdefaultò investment line in which the money coming from the TFR would be automatically invested, the law stated that it had to guarantee the return of the contributions paid plus a yield ñcomparableò to the revaluation rate of the TFR (see footnote 6).

[9] Law 23.8.2004 n. 243 delegated the Government to introduce the new rules for supplementary pension funds. The Government approved the new rules at the end of 2005, with the legislative decree 5.12.2005, n.252.

[10] A residual pension fund was set up with INPS (the main Italian social security agency), in order to allow the automatic enrolment of workers of sectors where labor contracts did not provide for any fund.

Several other new rules were introduced with the purpose of increasing the scope for competition in the field of plans directed to private-sector employees[11]. In particular, open pension funds were allowed to host occupational schemes for individual companies also in industries where a contractual fund was in place; additionally, constraints and fiscal rules were removed that in practice did not allow individual workers to freely select the open pension fund (or the insurance-based personal scheme) where they wished to direct the flow of TFR ï although the payment of the employerôs contribution into the fund selected by the employee would still be conditioned on the agreement of the employer.

Originally, the implementation of automatic enrolment was planned for the first half of 2008. Then, after the general elections in May 2006, the new Government that came into power took the view that the implementation had to be shifted earlier, to the first half of 2007.

There was another important change: firms with 50 or more employees would be obliged to transfer in favour of the Treasury the flows of TFR that workers did not want to be paid into the pension funds (thus keeping untouched their rights regarding the TFR). This arrangement ï besides generating additional revenues for the public budget ï would make the decision of their employees neutral to the larger firms (except than for the payment of the employerôs contribution), as they would be obliged to pay out the flow of TFR anyway[12]. On the other hand, firms with less than 50 employees would not be in such a neutral position vis-à-vis the decisions of their employees, also considering that the measures that should have allowed them to get additional bank financing were not put forward.

The final, formal decisions were taken only in late 2006, and a few days later the ñsemesterò began in which employees had to consider whether to refuse the transfer of their TFR into the pension funds.

With little time available, a ñrushò phase took place for all the actors involved.

COVIP, the pension regulator/supervisor, had to re-draft all secondary regulations, to make them consistent with the new law. This included a special emphasis on the information to be given to actual and potential members, in order to ease comparisons between schemes and foster competition. A new, comprehensive information document was set up, imposing the same format to all kinds of pension schemes; a synthetic indicator of all charges was introduced.

All pension providers (contractual pension funds as well as financial and insurance companies) had to re-organize their offer of pension plans to adapt to the new rules, and prepare all the necessary documents to apply for approval from the regulator. A bunch of new initiatives was also put forward, in particular contractual funds in industries where they were still missing.

11 The new legislation aimed also at strengthening supervision, and entrusted COVIP (the specialized pension regulator/supervisor) with additional powers, in part previously assigned to other supervisory bodies.

12 The transfer is made to an account set up with INPS, the main Italian social security agency, in favour of the Treasury. The sums collected count as current revenues in the public budget, accordingly to the corresponding liabilities (that will be recorded as expenses when they will occur).

Subsequently, COVIP had to consider all the applications and grant the approvals and the new licenses in time to allow the funds to collect the new members before the semester elapsed.

The employers were requested to inform their employees of the auto-enrolment mechanism, specifying the ñdefaultò occupational fund in which they would be enrolled, and of the possibility to opt-out. In particular, they were requested to ask each and every worker to compile a form (issued by the competent ministries) reporting whether or not he/she accepted the transfer of the TFR into the pension fund.

Besides these formal requirements, all involved actors had to face with the major task of communicating to the workers, in the little time available, the contents of the reform, the implications of the auto-enrolment mechanism, and the options available to them.

The Ministry of Labour ran a major campaign, directed to the public at large, to increase awareness about the reform. All media were used, with special emphasis on TV and radio; a dedicated web site was created (jointly with COVIP), www.tfr.gov.it; a call center was set up; special events (such as two ñTFR daysò) were organized. The effectiveness of the campaign was monitored both during and after it was conducted[13].

In the workplace, many, capillary communication initiatives (campaigns, meetings, etc.) were organized by employers and trade unions, often together with the relevant contractual funds. Financial and insurance companies invested in advertising and other marketing initiatives in order to promote their pension products; they targeted not only individuals, but also small and medium companies, in the attempt to develop business in occupational pensions.

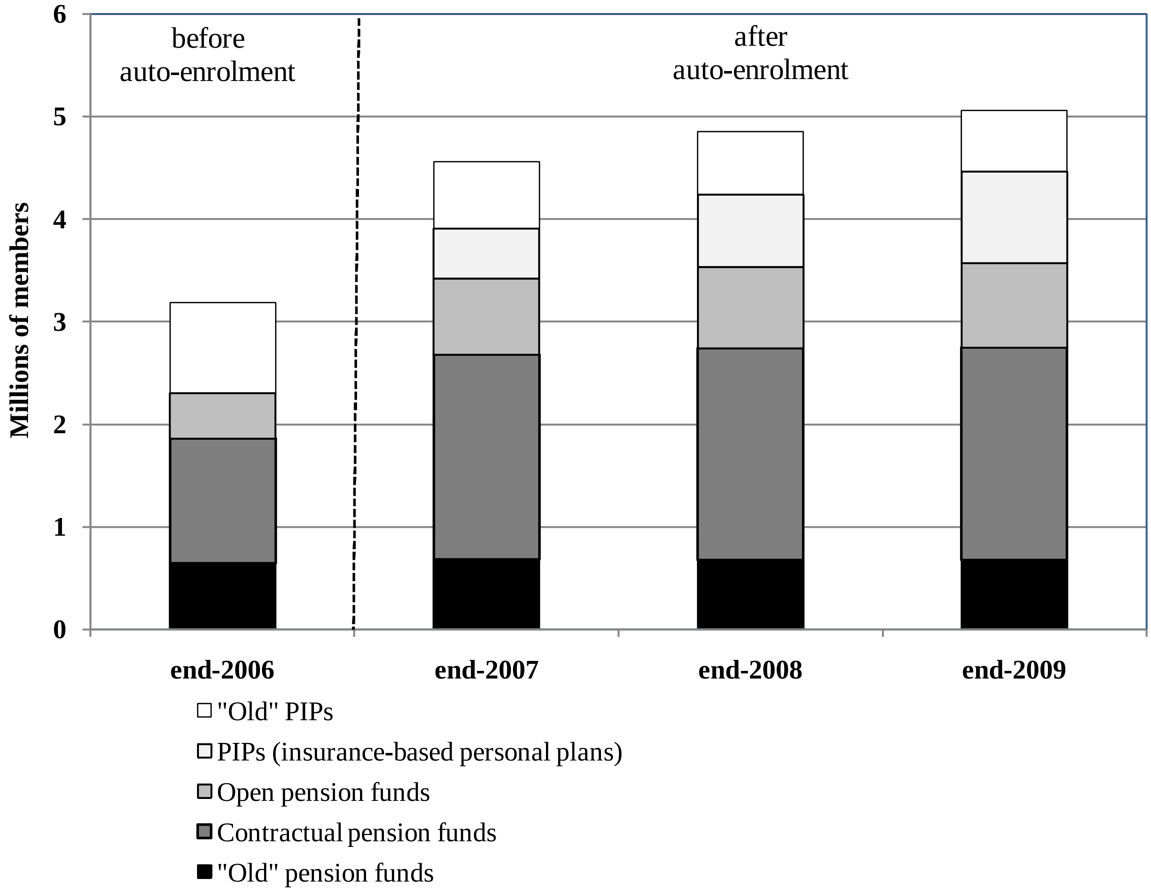
4. The results

Net of certain categories, such as short-term and seasonal temporary workers, as well as housemaids, the reform involved about 12.2 million private-sector employed workers, and several hundreds of thousands of companies. When the semester elapsed at the end of June 2007, it took some time to clarify the position of many workers; a complete and reliable picture of the results become available only at the end of 2007.

At that date, around 4.6 million workers were counted as enrolled in supplementary pension plans, or about 20% of all workers, with an increase of 1.4 million with respect to end-2006, before the implementation of auto-enrolment. The increase was concentrated among the employed workers of the private sector (with an increase of 1.2 million, they reached 3.4 million members at end-2007 ï about 27% of their total).

[13] See Ministero del Lavoro, ***ñ****Monitoraggio sulla campagna di comunicazione sul TFR*ò, Powerpoint presentation available on the website www.tfr.gov.it .

Pension fund members before and after auto-enrolment



Overall, the increase was significant, but certainly not satisfactory and at odds with previous experiences in other contexts and suggestions coming from behavioural economics. The more so, the great majority of new members came out from explicit adhesions, and not from the auto-enrolment. Only a number of workers estimated at 67.000 were automatically enrolled, around 5% of new members among private-sector workers.

The reasons for such outcome are discussed in the next section. Before doing so, it is useful to list some other information about the results:

- Membership rates continued to be very diverse across sectors and funds ï mainly depending on the firm size and the presence of trade unions ï confirming and even reinforcing the differences that were present before the implementation of auto-enrolment.

- Large differences in membership rates by gender, age group and geographic area, already in place before the reform, were also confirmed: membership continued to be higher in Northern and Central Italy, among men, and the older workers ï and lower in the South and the Islands, among women, and the young. In synthesis, membership rates in supplementary pension funds continued to be much higher among ñstrongerò workers, likely to have more stable jobs, higher salaries, and richer public pensions when they retire.

– In the following two years, membership results did not improve much. At end-2009, total membership was slightly over 5 million workers[14]. Moreover, it is worth noting that the bulk of the new adhesions in 2008-09 were in favour of individual plans (mainly PIPs, the insurance-based personal plans ï thanks to the effective sales network of insurance companies), while new adhesions to contractual pension funds were limited at about 50,000, with many funds that experienced no further growth or even reductions in membership. On the other hand, the role of auto-enrolment increased in relative terms: from 5% of new adhesions of private sector workers in 2007 to 30% in 2008 and 38% in 2009.

5. **Explaining the results**

5.1 Structural factors

Several structural factors contribute to explain the limited success of auto-enrolment in Italy.

First of all, disposable income for the average employed Italian worker is not high, mainly because of a large difference between cost of labour and net wages, due to income tax and social contributions[15]. In particular, total (employersô and employeesõ) compulsory social security contribution rates stand at 33 per cent of gross wages. Given the competitive pressures to which the Italian economy is exposed, it is not clear whether there is much room for additional resources to be allocated to pensions.

Second, vis-à-vis conservative investment options, the TFR is a strong competitor as a saving vehicle: it offers a risk-free rate of return that, although low in nominal terms, is still clearly positive in real terms, in the current low-inflation environment[16].

Third, the TFR has historically been an important source of cheap financing for employers. As mentioned above, the TFR reform has cancelled this possibility for firms with 50 or more employees. Smaller firms though (so important in the Italian economy)[17] are not neutral vis-à-vis the decision of their employees, because they still keep as a liability in their balance sheets the TFR of employees that refuse to enrol in the pension funds (besides not paying the contribution set by the relevant labour contract). Given the tight relations in place in small

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[14] At end-2009 Italian supplementary pension plans accumulated resources for 73 billion euros, about 4% of GDP.

[15] According to OECD, and taking as a reference average-earning unmarried workers with no children, in 2009 Italy ranked 22nd among OECD countries for net, in the pocket, wages (with about 15.900 euro) ï while it ranked 19th (with about 29.600 euro) for the average cost of labour of the corresponding worker. See OECD (2009) , ñ*Taxing wages*ò.

[16] It is worth noting that the revaluation mechanism of the TFR currently in place (see footnote 6) was set in 1982, when the annual inflation rate in Italy was in the region of 10%, implying a revaluation rate for the TFR significantly negative in real terms.

[17] More than half the workers of the private sector are employed in firms with less than fifty employees.

firms, employers may have influenced the choice of their workers regarding whether or not to enrol.

Fourth, the financial and economic crisis, although might not have had an effect on enrolment in the first half of 2007, certainly has made things more difficult in 2008 and 2009. The crisis has tightened liquidity constraints for potential members and for smaller firms, and has increased risk aversion, hindering confidence in pension plans investing in financial markets.

5.2 Implementation factors

Besides the factors listed above, that are difficult to overcome as they are embedded in the characteristics of the Italian economy, there are a few aspects of the implementation of auto-enrolment that still may be seen as sub-optimal; these aspects are of major interest in order to derive useful hints for the implementation of similar programs in the future.

First of all, the efforts to create pension awareness were insufficient, given the low level of financial literacy across Italian workers as well as their scarce knowledge of the implications of pension reforms of the nineties[18]. In particular, after the adoption of the notional defined contribution system individual workers were not informed of the amount of the annuity that they could reasonably expect to receive: no such a thing as the Swedish ñorange envelopeò was distributed to Italian workers[19].

The rescheduling of auto-enrolment one year earlier certainly did not help. Important aspects of the implementation were defined just before or even after the ñsemesterò began. Most of the information campaign run by the Ministry of Labour was concentrated in the last part of the semester. Most of contractual pension funds and financial and insurance companies offering open plans completed the review of their products and the fulfilled the requirements for the necessary authorizations only a few weeks before the semester elapsed.

In addition, there were two aspects of the communication strategy that may be seen as critical.

First, regarding public pensions, authorities were reluctant to convey a clear message regarding the dimension of the reduction that workers should expect. The reason for this was that certain aspects of the rules to be applied were still open to negotiations between the Government and the social parts. In particular, the periodic revision of coefficients that would transform into an annuity the notional capital accrued at retirement ï revision needed in order to keep up with increased life expectancy and maintain the system in actuarial equilibrium ï although already

[18] See the following section for some evidence based on a surveys of Italian workers run in 2008, the year after the implementation of auto-enrolment.

[19] At the time of writing this paper, no ñorange envelopeò has yet been distributed , although plans to do so have been announced.

written in the law, was put in doubt for some time. This uncertainty was reflected in the communication that was set up.[20]

A second, possibly more tricky, aspect of the communication strategy that is worth discussing concerns specifically the auto-enrolment process. More than explaining the reasons why the option that would automatically apply should be considered appropriate, emphasis was put mainly on the ñ*importance to choose now*ò[21]; i.e. on the need for each worker to assess carefully (and rapidly) the options available. Somehow, the communication campaign looked more consistent with a framework where enrolment is fully voluntary and requires each individual to explicitly express the willingness to become a member, than with a more ñpaternalisticò framework where authorities are truly convinced that an appropriate default option has been defined, and individuals are encouraged to take it for good or opt out only in special circumstances.

Specific details of the implementation reinforced this approach, such as the requirement for employers to ask every employee to compile a form where to indicate whether he/she accepted the default option, or wanted to opt-out (clearly, asking to fill such a form would have been really necessary only in this latter case).

As a result, it is likely that the prevalent message conveyed to the workers was that of a neutrality of public bodies with respect to the options offered[22]. Such a message, together with the irreversibility of the choice in favour of paying the TFR into the pension funds (another aspect that might be criticized) may have induced uncertainty, anxiety, and procrastination of choice among workers. Actually, it is reported that the preference for opting out and keeping the TFR increased while the campaign was run.

The way the ñdefaultò option was designed also contributed to the low number of automatic enrolments (i.e. ñsilentò enrolments, as they has been usually labelled in Italy). Indeed, the default option set up by law was (in most cases) <u>not optimal from the side of the employee</u>, neither as regards contributions nor the investment profile.

Indeed, labour contracts applicable to most employed workers provided for an employerôs contribution (usually in the range of 1-1.5% of gross wages) conditional on the payment into the fund of a matching contribution by the employee. Where the individual employee remained silent, only the TFR would have paid into the pension fund, with the employersô contribution becoming a deadweight loss ï a clearly inferior option for most workers (possibly with the

[20] For example, while in the official projections published by *Ragioneria Generale dello Stato*, the estimates of the replacement rate took into account the revision of coefficients, brochures prepared for the communication campaign (and directed to the general public) made different assumptions, and presented higher estimates of the future replacement rate.

[21] ñ*L**ô***importanza di scegliere ora*ò was one of the slogans most frequently used in the campaign.

[22] One could even argue that the competent authorities were ambivalent with respect to the willingness to achieve a truly high enrolment rate, as for larger firms the TFR not paid into pension funds would become a revenue for the Treasury. It is worth noting that in 2008 the flow of TFR paid to the Treasury reached the significant amount of 5.3 billion euro.

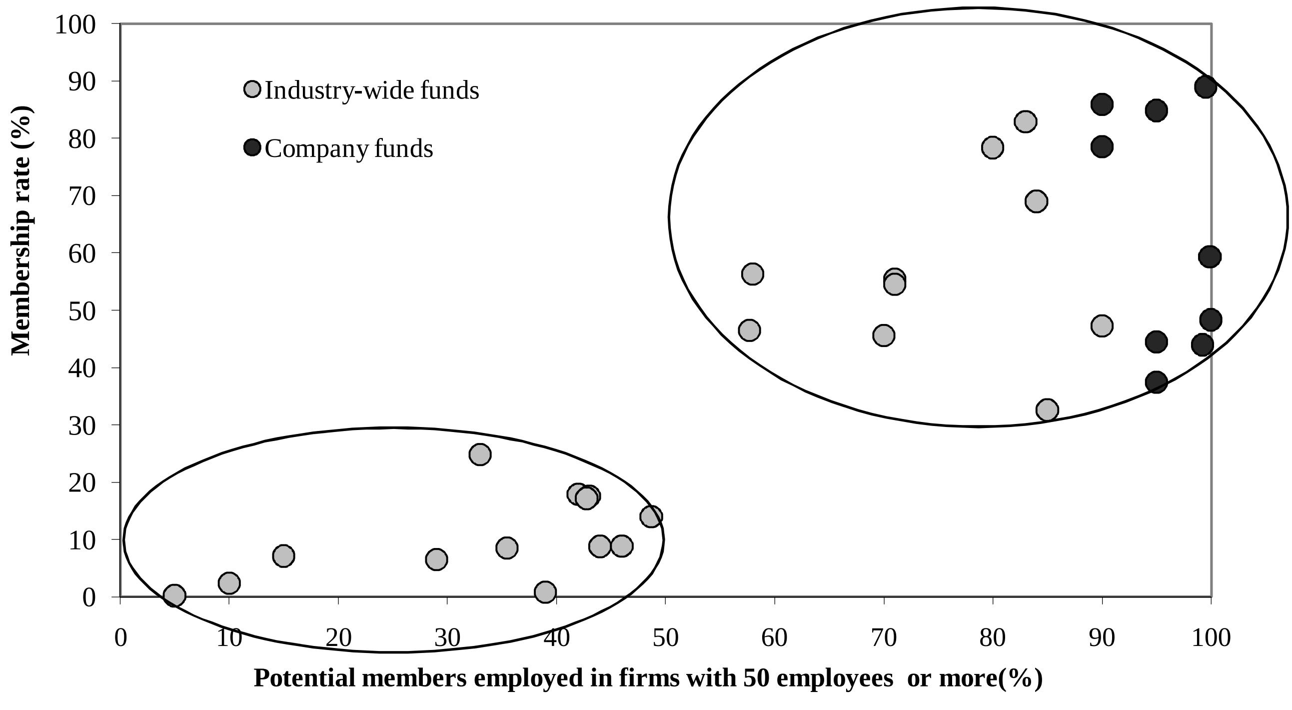
exception of those with severe liquidity constraints, that impeded them to pay for their matching contribution).

As regards the investment profile, a very conservative default option was set up by law: a guaranteed line of investment, ensuring the return of paid contributions, plus a yield ñcomparableò to that of the TFR. However, taking into account the pressure to keep costs low, and the historically low interest rates offered by high-quality bonds, this investment profile offers very limited prospects to perform significantly better than the TFR. Moreover, no recognition was given to the different time horizons available to workers of different age, and the selected default option may be considered unsuitable especially for the young.

Again, the message implicit in the default options set up by law was not of confidence in the ability of pension funds to provide in the long run, investing workersô money on the financial markets, a superior performance to that ensured by the TFR.

It is worth noting that, despite the sub-optimal arrangements made in terms of default options and awareness campaign, in a few cases employers and trade unions were indeed able to offer a more positive message and obtain significant results in terms of membership. As shown in the following figure, company funds and a bunch of industry-wide funds have reached satisfactory membership rates, in a few cases around and over 80%[23].

Contractual pension funds: membership rate and firm size



[23] Also at regional level there are positive experiences (e.g. *Trentino Alto-Adige*), that have led to higher membership rates than the nation-wide average.

A specific survey run for one of these successful funds[24] suggests that an important role was played by the information flow among employees that is possible in large plants (a sort of ñcafeteria effectò). The figure suggests that at the level of individual funds two equilibria emerged: a good one, where communication was good, and membership high; and a bad one, where communication was poor (and possibly distorted by the conflict of interest occurring on small employers regarding the destination of the TFR of their employees ï see above) and membership low.

6. Some evidence on financial literacy and pension awareness among Italian workers

Before drawing conclusions on the Italian experience with auto-enrolment that may be useful for designing other programs in the future, some evidence is reported on financial literacy and pension awareness; the evidence was collected through a survey in June 2008, a few months after the implementation of auto-enrolment and before the blowing-up of the financial crisis later in that year.

The survey was commissioned by COVIP, in order to better understand the factors influencing workersô choices regarding pension fund membership. It was focussed on employed private sector workers, and run by telephone interviews with a sample of about 1000 respondents.

Some descriptive statistics of the results are reported below, focussing on the differences between respondents that declare to have enrolled in a pension plan and the others[25].

Questions on financial literacy	**% of correct replies**		
	entire sample	**pension fund members**	**not pension fund members**
Compound interest rate	53,5%	59%	52%
Inflation perception	48,5%	53%	47%
Difference between stocks and bonds	49%	55%	47%
Effect of diversification on risk	53%	61%	51%
Relationship between the price and the yield of bonds	11,4%	12,9%	11%

[24] The survey was run among the members of *Fonchim*, the nation-wide fund for chemical industry (and the first one to be instituted under the new legislation), that at end-2007 reached a membership rate above 80% with over 160.000 members. The largest fund in Italy is *Cometa*, the nation-wide fund for the steel industry, that at end-2007 reached a membership rate slightly below 50%, with more than 470.000 members. At end-2009 membership for both funds was slightly lower.

[25] For a more complete description of the results of the survey, some econometric analysis, and a comparison with results found by the *Banca dõItalia* survey of Italian households, see Ceccarelli-Rinaldi (2010), mimeo.

Sample size	*981*	*224*	*757*

We asked five questions about financial literacy, replicating the questions suggested by Prof. A. Lusardi and used in surveys run in many countries.

The five questions asked on financial literacy show results in line with those found for other countries for the sample of employed workers. For each of the questions, correct answers are slightly higher for workers that declare to be members of supplementary pension plans.

It is worth noting that pension plans members showed a relatively higher understanding of the effects of diversification on risk. On the other hand, one may also note the very few correct answers received by the question on the relationship between the price and the yield of bonds.

Another set of questions was asked, regarding the awareness of workers on some key features of the reform of the public pension system.

Also in this case, replies show a positive correlation between ñpension awarenessò and the decision to adhere to pension funds. However, the overall level of awareness looks low (although international comparisons are not readily available in this case).

Questions on awareness of reform of public pensions	**% of correct replies**		
	entire sample	**pension fund members**	**not pension fund members**
Your benefits will depend: only on the contributions you pay / only on your salary as an active worker / on both / do not know	28,5%	32,6%	27,2%
In the PAYG system (ñ*sistema a ripartizione***ò**), contributions paid today are used for: paying current retirees / paying future benefits to current active workers / both / do not know	37,2%	44,6%	35%
Sample size	*981*	*224*	*757*

It is worth noting that preliminary results of econometric analysis through probit models show a possibly stronger effect of pension awareness vs. financial literacy on the decision to adhere to pension funds. This may be a useful finding for policy purposes, as may help define priorities in information and awareness campaigns.

7. <u>Conclusions and policy suggestions from the Italian experience</u>

This paper has discussed the Italian experience in developing its system of private, supplementary pensions, as a case study for the implementation of nation-wide auto-enrolment mechanisms, devoting attention to pension awareness issues.

Exploiting peopleøs inertia and overcoming procrastination, auto-enrolment is (increasingly often) seen as a nice middle course between fully voluntary arrangements and compulsory mechanisms.

Fully voluntary systems rely heavily on the ability of individuals to take appropriate, informed decisions; given the complexity of pension products, this ability requires a degree of financial literacy and pension awareness that is difficult to achieve. On the other hand, mandatory solutions, in principle, are distortive of individualsô preferences and may be politically unfeasible.

Auto-enrolment is thus inspired to a form of soft ñpaternalismò, that recognizes that individuals need to be ñnudgedò in the right direction, while sees as culturally unacceptable the outright imposition of ñone size fits allò mechanisms. Anyway, auto-enrolment should be seen as a complement, rather than a substitute, of education efforts aiming at empowering people to take the decisions that best suit them.

Though, auto-enrolment may be tricky to be put in practice, as the Italian experience clearly shows.

Besides the importance of country-specific structural issues, this paper wishes to underline the need to insert auto-enrolment in a comprehensive policy strategy encompassing all components of the pension system. In such a framework, all the policy instruments regarding different aspects of pensions should be used consistently: not only in order to achieve the desired membership targets, but also as a prerequisite for effective awareness campaigns and education efforts.

A consistent policy strategy is needed to communicate to the public at large a truly convincing message about the reasons to foster the role of supplementary funds, increase membership, achieve the desired size of contributions, invest them appropriately. All instruments available (auto-enrolment, default options, financial education, information to members, regulation, competition policy, etc.) have thus to be used consistently, in order to exploit their potential complementarity[26].

As an important starting point, it has to be ensured that the framework of public pensions is sufficiently stabilized and that clear and comprehensive information can be (and is) supplied in order to make people aware of its evolution both in the short and in the long run. This is all the more essential when important reforms of the system are introduced.

[26] Many works conducted in the framework of the OECD Working Party on Private Pensions, as well as of IOPS (*International Organization of Pension Supervisors*) underline the complementarities of different policy instruments in the pension field. In particular, see Rinaldi-Giacomel(2008), *Information to members of DC pension plans: conceptual framework and international trends*; IOPS working paper no.5.

A second major point is the importance of appropriate default options that back-up the individual when he is unable or unwilling to choose; default options are important not only because they gently force individuals to ñtakeò the right decisions, but also as complements to education and information efforts, because they convey information and advice in a simple and effective way.

A third, final point has to do with the need to ensure an appropriate balance of responsibilities between the individual, the State, and the intermediate bodies (such as social partners) in the allocation of decision to be taken regarding pension issues. For example, while the overall design of the auto-enrolment system may well be designed by law at nation-wide level, the principle of subsidiarity may suggest that employers and social partners are best fitted in order to set the specific default options regarding contribution rates and investments.

In any case, it is important that the individuals are not left alone facing many difficult choices regarding their pensions; a consistent policy strategy and an appropriate mix of instruments, including information and education efforts, should be put at work. A sensible balance of appropriate design, intelligent nudging, empowerment efforts, and freedom to choose is essential to deliver the pension solutions that are most likely to suit best the great majority of workers.

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