OpenRetirementClub response to the HM Treasury Consultation on Creating a Secondary Annuity Market

OpenRetirementClub is a division of Owen Pensions Limited providing pension information and guidance to its members.

The Government's proposal for a secondary market in annuities is flawed.

The proposal is that people who have purchased annuities might want to swap the annuity income they purchased for an immediate cash lump sum or a flexi-access drawdown account. To do so, the Government recognises that a new industry would need to be encouraged to "buy" the annuity income stream in return for a cash payment. In its consultation paper, 'Creating a secondary annuity market', the Government asks the insurance and pension industry to consider how this market would work. The paper muses that regulatory costs could make "costs so high that they prevent a market from growing". Given what has happened since 6th April, I think they are right to be concerned.

But my concern is with how this market could ever act in the interests of the consumer. As the Government recognises "individuals are likely to find valuing their annuity difficult", because

1. it requires an understanding of net present value mathematics;
2. people have a behavioural bias towards cash now;
3. people seriously underestimate how long they will live and therefore the value of the annuity.

So why do I think that encouraging a secondary market in annuities is a bad idea?

Because

1) people will accept cash that is below the true value of the income they are giving up. For those with small pension pots who bought particularly poor value annuities this will compound the catastrophic loss of their savings;
2) the new market would be ripe for the entry of even more "scammers" cold calling the vulnerable with offers of cash well below the net present value of the annuity;
3) the costs to the industry would be enormous. Compliance checks would need to be added to check the buyers of the annuities, whether the seller had taken advice, whether the second life in a joint annuity contact had consented, and many others;
4) Requiring people to pay for financial advice before on-selling their annuity is wrong and probably unworkable.

I think the Government got carried away with its pension freedom agenda. It wanted to give individuals who had bought contracts for annuities a way to access the same freedom and choice as those who had not. In its consultation paper, the Government admits there is an alternative – to require annuity providers to "buy-back" annuities – but is worried about the effect this would have on the industry.

I believe the current proposals should be replaced by the compulsory "buy-back" of certain annuities of the poorest value.These would include those sold to owners of very small pots in the years since the financial crisis of 2008. These contracts were sold with annuity rates up to 2% lower than the rate for larger annuities on the grounds that they were expensive for the insurance companies to administer. If this was the case, I can see no reason why the insurance industry would mind buying back these "expensive" annuities. To ensure fairness, the Government could set the discount rate at which these annuities should be re-purchased. In practice, the insurance company and the consumer would then be entering a second "buy-back" contract rather than negating the first.

Many annuities sold in the past were the correct retirement income arrangement for the consumer. Why introduce a new market to allow these arrangements to be reversed, particularly when such a market would be both costly to regulate and rife with dangers for the consumer?