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RETIREMENT AT RISK: LAST OF 3 PARTS

Unions' Advice Is Failing Teachers

Labor groups have joined forces with investment firms to steer members into savings plans that often have high expenses and poor returns.

By Kathy M. Kristof
Times Staff Writer

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Second-grade teacher Crystal Mendez was in the staff lunchroom at 42nd Street Elementary in the Crenshaw district when an investment broker introduced herself and started talking up a retirement plan.

Mendez, fresh out of college, thought she could trust the woman because her company had been endorsed by the Los Angeles teachers union.

Mendez agreed to put $400 a month into a retirement account. She assumed her money would be invested in stocks. Just 22, she figured she had plenty of time to ride out any dips in the market. She said the saleswoman told her: "Leave it to me."

Nearly two years later, when her boyfriend started bragging about the returns he was earning on his 401(k), Mendez took a closer look at her own account.

"He was earning 15% a year and I was earning 3%," she recalled. "I thought, 'There's something wrong here.' "

Mendez's money was languishing in a fixed-rate annuity, an investment ill-suited to someone in her early 20s. Worse, she would have to pay a steep penalty to bail out.

Public-school teachers across the country are in similar predicaments. And many have their unions to thank for it.

Some of the nation's largest teachers unions have joined forces with investment companies to steer their members into retirement plans with high expenses that eat away at returns.

In what might seem an unlikely partnership, the unions endorse investment providers, even specific products, and the companies reciprocate with financial support. They sponsor union conferences, advertise in union publications or make direct payments to union treasuries.

The investment firms more than recoup their money through sales of annuities and other high-fee products to teachers for their 403(b) plans — personal retirement accounts similar to 401(k)s.

New York State United Teachers, for instance, receives $3 million a year from ING Group for encouraging its 525,000 members to invest in an annuity sold by the Dutch insurance giant.

The National Education Assn., the largest teachers union in the country with 2.7 million members, collected nearly $50 million in royalties in 2004 on the sale of annuities, life insurance and other financial products it endorses.

Teachers unions across the country — including those in Las Vegas and San Diego and statewide teacher associations in Pennsylvania, Michigan and Oregon — have struck their own endorsement deals.

Unions in Dallas, Miami, Phoenix, Seattle and Atlanta, among others, refer members to products approved by the NEA and typically receive a share of endorsement revenue in return.

Many teachers say they presume an endorsement means their union has used its clout to get the best price, as unions do on products from eyeglasses to automobiles. But when it comes to retirement accounts, union backing is often a sign that the product will cost more, not less.

Buyers of an NEA-endorsed annuity sold by Security Benefit Life Insurance Co. pay annual fees totaling at least 1.73% of their savings. That is about 10 times as much as they would pay in 403(b) plans available from Vanguard Group, T. Rowe Price and other low-cost mutual fund providers.

The costliest option in the NEA-endorsed plan charges 4.85% a year. That means an investor would have to earn a return of nearly 5% just to break even.

Union leaders defend the endorsement deals and the prevalence of high-fee annuities. They say that teachers get valuable advice from brokers and financial advisors in return for the fees, and that the companies' contributions to union coffers help pay employee salaries and other union expenses.

Yet no one disputes that this money ultimately comes out of teachers' pockets.

"The nature of the marketplace is such that you have these little under-the-table payments, or whatever you want to call them, and a good-old-boy network that really works against the teachers," said Mark Fischer, who runs an Ohio company that designs and manages retirement plans.

The 403(b) accounts are key to teachers' financial security. Most can count on receiving pensions when they retire, but many are not covered by Social Security. For that reason, Congress in 1958 allowed teachers and other nonprofit employees to establish savings accounts under section 403(b) of the Tax Code. Today, an estimated $607 billion is invested in these accounts.

As with a 401(k), the nest egg grows tax-free until the owner retires and starts making withdrawals. But there is a key difference. In the private sector, employers sponsor 401(k) plans and are required to screen the investment options and make sure employees have reasonable choices.

School districts are under no such obligation. Most leave it to teachers to find their own investments.

As a result, hundreds of insurers, mutual fund companies and financial planners compete for teachers' money, touting a bewildering array of products. A union endorsement confers a huge advantage, allowing a provider to stand out from the crowd.

Unions do more than simply give companies their blessing. Some help market and sell endorsed products. They tout investment firms on their websites and provide direct links to sites where teachers can sign up to buy annuities. Endorsed providers also enjoy special access to schools and teacher conferences where they can pitch their products.

Teachers generally are not aware that unions are paid for their endorsements, directly or indirectly. Such deals usually are not mentioned on union websites or in brochures describing the favored investments.

"This is a national problem," said Dan Otter, a former Maryland teacher and founder of 403bwise.com, which offers tips on finding low-cost retirement plans.

"It's a rare school district that gives teachers access to quality choices. In most cases, they just turn a blind eye to the problems. And it's the rare union that's advocating for better 403(b) investments for its members," Otter said. "In many cases, the 403(b) is a source of profit for unions."

Vanguard Group says it doesn't even try to offer 403(b) plans to public-school teachers because of the costs involved. Unions want companies to offer in-person financial advice, a service typically provided by sales agents working on commission.

Vanguard keeps fees down by selling directly to customers over the Web and by phone, and it refuses to pay for endorsements.

"There are costs just to participate," said James Norris, a top Vanguard executive, citing such expenses as entertaining union leaders and fielding a sales force. "Those costs have to be offset by revenues, which is why you end up with relatively high fees."

United Teachers Los Angeles, which represents 44,000 members in the Los Angeles Unified School District, doesn't receive direct payments for its endorsements. But firms that get its seal of approval can be counted on to advertise in the union newsletter and donate to union causes.

"It allows us to put the touch to them when we are raising money for any purpose," said UTLA spokesman Steven Blazak. "For the times that we come to them and say, 'Will you be a sponsor and kick in a few hundred bucks?,' it's nothing in the grand scheme of things — not compared to the money they are making."

Poor Showing

Most of the money in 403(b) plans is invested in annuities — insurance contracts designed to provide regular payments in retirement. Annuities come in two general types. A fixed annuity grows at a set interest rate. A variable annuity is tied to the performance of a mutual fund.

Insurance provisions are key selling points. The stock market goes up and down, but annuities offer guaranteed payments. A tax-deferred annuity — the kind teachers are encouraged to buy — also comes with a death benefit that ensures the buyer's beneficiaries will get at least the amount invested.

But those features come with fees that reduce investment returns. In addition, in the early years of an annuity, investors cannot move their money out without paying a penalty. Many personal finance experts say most people would do better to put their savings in low-cost mutual funds outside of annuities and buy term life insurance if they need to protect beneficiaries.

Art Dawe, who teaches English as a second language in Middletown, N.Y., said the state teachers union's endorsement was the key factor in his decision to buy an Opportunity Plus variable annuity from ING Group. Opportunity Plus allows teachers to choose from a variety of mutual funds with the help of a financial advisor.

Dawe said he took a close look at his account two years ago and realized he had earned an average of 1.6% a year since 1990. By comparison U.S. mutual funds overall grew an average of 8.4% a year during that period.

"I could have fared better with Atlantic City slots," he said.

Dawe's returns were paltry in part because he paid ING 3.59% of his assets each year in fees. Of that, 0.67% went to operating expenses for his annuity. An additional 1.92% was taken out for management fees for the mutual funds he chose. Finally, 1% was deducted to pay for the death benefit.

T. Rowe Price Group offers a 403(b) plan with a low-cost mutual fund that charges just 0.35% a year. The mutual fund lacks the insurance features of an annuity but costs less than a tenth of what Dawe paid in fees.

Dawe said he couldn't understand why the union had endorsed the annuity — until he read about ING's payments to the union on Otter's website.

"I was under the impression that because it was from the union, it would be in my best interest — because they're in my best interest," he said. "Now, I kick myself in the butt for buying it."

Dennis Tompkins, a spokesman for New York State United Teachers, says the endorsement deal is good for members because it helps underwrite the union's benefits department and other services.

Although annuities have higher expenses than other investments, Tompkins said, they provide more value because the financial planners and insurance agents who sell them offer financial advice.

"A lot of our members are beginning investors who need a lot of hand-holding and guidance," he said.

ING offers a lower-cost retirement plan for New York teachers, called Opportunity Independence, that does not include financial advice, a death benefit or other annuity features.

But the vast majority choose the Opportunity Plus annuity, said Kathleen Murphy, ING's group president for institutional financial services.

"Overwhelmingly, the teachers have chosen the higher-service model because they want help, education and advice," she said.

A Share of the Royalties

The NEA-endorsed annuity, called Valuebuilder, charges 0.9% to 2.6% a year in fees and expenses — not including management fees for the mutual funds available through the plan.

When the fund fees are added, investors pay a minimum of 1.73% of their account balances each year. The most expensive combination of mutual funds and insurance features costs 4.85% a year.

A fee that large can ravage retirement savings over time. A teacher who contributed $500 a month and earned an average of 10% a year would have $379,684 after 20 years. But if 4.85% in fees were deducted each year, the nest egg would amount to just $209,114.

The NEA receives royalties on sales of Valuebuilder and other financial products it endorses. Union officials declined to say how the royalties were calculated or how much money union-endorsed retirement plans brought in.

They are, however, required by federal law to disclose the total revenue from all endorsement deals. The most recent disclosure on file with the Labor Department shows that the NEA received $49.6 million from Security Benefit Life Insurance, the provider of Valuebuilder, and other endorsed companies in 2004.

Among other things, that money pays the salaries of 110 union employees, said Ronald Mentzer, treasurer of NEA Member Benefits in Gaithersburg, Md.

In addition to its direct payments, Security Benefit sponsors dozens of NEA conferences each year.

NEA officials said they endorsed the insurer's annuity because they wanted a provider with a national sales force to serve affiliate unions.

"There are companies that have lower fees, but they don't have the distribution structure that our members tell us that we needed," said Gary

Phoebus, an NEA spokesman in Washington.

Local unions that help promote NEA-endorsed products get a share of the royalties. The Florida Education Assn., for example, collected $140,000 in "program royalties" last year, federal records show. The Illinois Education Assn. received $178,148, while the Maine Education Assn. was paid $33,610.

The rival American Federation of Teachers has a far less lucrative arrangement with ING Group. The 1.3-million-member union endorses ING as a provider of 403(b) plans but does not share in sales revenue. Instead, ING reimburses the union for the money it spends promoting the insurer's products.

Those payments have totaled less than $50,000 since the agreement took effect in 2003, said John Abraham, the union's deputy director of research. The lower overhead translates into lower-cost options for teachers. ING offers American Federation of Teachers members a choice of mutual funds with fees as low as 0.25%, as well as an annuity with higher expenses.

"We do not have a royalty arrangement like NEA," Abraham said. "All of our deliberations with ING … have centered on getting lower fees for members and more benefits and services going forward. It's a membership organization. We just feel like it's the right thing to do."

'Guided Investments'

Companies endorsed by United Teachers Los Angeles return the favor in various ways. Some pay thousands of dollars to rent exhibit booths at the union's annual leadership conference in Palm Springs.

"We owe it to them," said Bob Sandstrom, an insurance salesman, who paid $3,000 for space at the 2004 conference. "We are endorsed by the UTLA, and their endorsement is worth a lot."

At the same conference, CitiStreet Inc. treated about 60 teachers active in the union to dinner at LG's Prime Steakhouse, where the rib-eyes run $34 and up. One guest estimated the bill at $4,000.

CitiStreet, a partnership of State Street Corp. and Citigroup Inc., is one of five union-endorsed "preferred providers" of 403(b) plans. This allows its salespeople to meet with teachers on campus as invited guests of the union.

The broker who showed up at Crystal Mendez's Crenshaw district school two years ago was from Zahorik Investments of Pasadena, another preferred provider. Mendez said she filled out a questionnaire that showed she was comfortable taking risk and assumed she would be put in a stock fund.

Two years later, she discovered that her money was in a fixed-rate ING annuity with stiff exit penalties. To take her money out, she would have to forfeit 10% of her savings — $1,000. She did so, reluctantly.

"I could have stayed in for the 10 years and not paid the surrender fee," she said. "But we figured it would cost me more than that in lost investment returns if I did.

"I am incredibly disappointed," she added. "The union and the district should be doing a lot more to give us decent retirement choices."

Told about the teacher's experience, Toby Wills, a Zahorik vice president, said account paperwork separate from the questionnaire indicated that Mendez was a conservative investor, making the fixed annuity appropriate despite her age.

"If somebody says they need to be conservative, it's not my prerogative to drag them out of that," Wills said. "What if the market didn't perform?"

Judith Martindale, a certified financial planner in San Luis Obispo, said this approach did not serve the client's interests. Even if Mendez expressed a conservative attitude, she should have been advised to invest at least some of her money in stock funds, Martindale said. That's because the major long-term risk for an investor in her 20s is inflation, she said, not stock-market volatility, which tends to even out over time.

"Normally, when somebody that age says they're a conservative investor, they need education," Martindale said.

UTLA Treasurer David Goldberg said he knew nothing about 403(b) plans and the union's endorsed providers until he was elected treasurer last summer and received inquiries from the Los Angeles Times. In response, Goldberg said he had revived a dormant member benefits committee to look at the arrangements and eventually hoped to add low-cost options.

His predecessor, Alberto Valdivia, said the union did not endorse low-cost plans because it wanted teachers to have access to the investment advice offered by sales brokers.

"Teachers are trained as educators, not financial managers," Valdivia said. "What we are concerned about is guided, safe, secure investments."

Steve Schullo, a Los Angeles teacher and longtime critic of 403(b) endorsement deals, said this attitude reflected "an offensive prejudice that teachers are too stupid and too naive to manage their own retirement savings."

Many choose products sold by financial planners because they aren't aware that they cost more, Schullo said.

One of the UTLA-endorsed companies, Plan Member Services of Carpinteria, Calif., offers some of the most expensive retirement plans in the state, according to 403bwise.com.

The company sells mutual funds with a so-called wrap fee of as much as 2% to pay for investment advice and for periodically rebalancing teachers' portfolios to keep them diversified. The wrap fee is on top of management fees for the mutual funds.

In all, Plan Member investors pay fees ranging from 2.5% to 4.6% of their savings each year.

Troy Dueker, a Plan Member vice president, said the charges were reasonable in light of the service provided.

"We are giving Finance 101 lessons, explaining what a stock is, what a bond is," he said. "We take them through life-cycle planning."

Dueker said he did not know why or how his company was endorsed by UTLA. But a competitor, Eric Wolf, said his firm, Financially Responsible Educators, got the nod because it put some revenue back into the schools.

About 10 years ago, Wolf was pitching his products to a teacher in her classroom and noticed that she was collecting soda cans to pay for a new carpet. The teacher was planning to buy a fixed-rate annuity. Wolf decided to rebate part of his commission to pay for the rug.

When UTLA officials began screening companies for their list of approved providers, Wolf explained his habit of giving back. He made the list. He now funds a $1,500-a-year UTLA college scholarship for gay and lesbian students as well as field trips, supplies and other school needs.

"I pretty much never say no," he said. "We make a decent living from the school district. Why shouldn't we be giving back? The way the compensation is set up, there's enough to go around."

That's not how it works in Wisconsin, where the teachers union set up its own low-cost 403(b) program.

The Wisconsin Education Assn., which represents most K-12 educators in the state, charges an annual fee of 0.3% of assets. The money pays the salaries of half a dozen registered securities representatives, who answer teachers' questions and provide financial advice over the phone.

"We have no profit motive. Our goal is to cover the cost of operations and keep the cost to participants as low as possible," said Randy Mullis, assistant executive director of the union's Tax Sheltered Annuity Trust in Madison.

Teachers are given a range of investment choices, including a Vanguard stock index fund that charges 0.05% a year. With the union fee, the total is 0.35% of assets — a fraction of the cost of most union-backed plans.

Several years ago, Mullis said, the NEA asked the Wisconsin union to help promote the Valuebuilder annuity.

"We said that in all good conscience, we can't do that," he said.

Times researchers Scott Wilson and John L. Jackson contributed to this report.

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(INFOBOX BELOW)

Comparing returns

Because of fees, annuities generally post lower returns than mutual funds with similar investment strategies. Here is how $10,000 invested in three Valuebuilder annuities from Security Benefit Life Insurance and endorsed by the National Education Assn. Performed compared with low-cost mutual funds with similar investment strategies offered by Vanguard Group.

5 years

Vanguard Global Equity (Foreign stocks): $18,167

Valuebuilder Security Global (Foreign stocks): $11,892

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5 years

Vanguard Wellington (Stocks and bonds): $14,050

Valuebuilder Van Kampen Equity & Income (Stocks and bonds): $12,618

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5 years

Vanguard Equity Income (Blue-chip stocks): $12,265

Valuebuilder Van Kampen Comstock (Blue-chip stocks): $12,125

Amounts based on actual fund returns for the five years ended Dec. 31. Return and cost data based on return calculator at http://www.sec.gov .

Source: Times research

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About this series

Three articles examining practices that put Americans' retirement savings at risk.

***Sunday:** Many 401(k) accounts are being eroded by unseen fees.*

***Monday:** Annuity providers are targeting the elderly, often with deceptive, high-pressure tactics.*

***Today:** Teachers unions are steering members into investments with high fees and poor returns.*

***On the Web:** To read previous installments, participate in a discussion forum or submit a question to Times personal finance columnist Kathy M. Kristof, go to latimes.com/retire.*
