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Teachers Pay High Fees for Retirement Funds. Unions Are Partly to Blame.

Groups representing municipal employees and teachers are often paid to endorse investment products

By Anne Tergesen and Gretchen Morgenson

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The pitch from the president of the Indian River County teachers union couldn't have been clearer.

Liz Cannon, who heads the Indian River chapter of the Florida Education Association, urged union members to buy retirement investments from Valic Financial Advisors Inc. through a firm owned by the union. That way "we also make money," she said in a November 2017 newsletter, through regular dividends.

What Ms. Cannon didn't mention was that investments from Valic, a unit of giant insurance company American International Group Inc., can carry high costs that may translate to a smaller nest egg when teachers retire.

The setup is one of an array of similar deals in which unions and other groups get income from endorsements of investment products and services—often at the expense of teachers and other municipal employees.

The ties help explain why many local-government workers continue to pay relatively high retirement-plan costs, while fees in corporate-based retirement plans are often lower and have been falling for years.

At issue are 403(b) retirement savings plans for teachers and 457 plans for government workers—variations on the 401(k) plans many companies offer. About $900 billion was held in 403(b) plans for public-school teachers and 457 plans at the end of June, according to the Investment Company Institute, a mutual-fund industry trade group.

In the crowded market, an endorsement from a union or municipal organization or affiliate can help an investment-product provider stand out. It also can give the provider's sales agents access to union meetings, teachers' lounges, benefit-enrollment fairs and professional conferences to pitch retirement and other products.

Valic's Portfolio Director, an annuity that is popular in teachers' retirement plans, charges fees of up to 2.3% of assets annually.

Fees average less than 1% in 401(k) accounts, according to research firm BrightScope Inc. and the ICI. The fees 401(k) participants pay for mutual funds that invest in stocks fell to 0.45% in 2017, on average, from 0.77% in 2000, ICI and BrightScope data show.

"The unions should be advocating on behalf of members, not selling products to them," said Scott Dauenhauer, a registered investment adviser in Murrieta, Calif., who specializes in financial planning for teachers. "They are there to protect teachers' rights, not exploit them."

The Securities and Exchange Commission is investigating sales and disclosure practices at Valic, including its dealings with school districts and retirement-plan participants at schools, the Journal has reported. The SEC is also looking at arrangements Valic had until recently with a company owned by local affiliates of the Florida Education Association, called Creative Benefits for Educators, and with other unions and school districts around the country, according to a person briefed on the inquiry.

A spokesman for Valic said, "It is our longstanding policy to cooperate with such inquiries, while also taking any necessary steps to ensure compliance with the law and best practices."

The spokesman said Valic's Portfolio Director is just one of a range of retirement-plan investments Valic offers, and an investor would pay the top 2.3% fee only if he or she chose a specialized fund that contains a very small part of the assets Valic handles in retirement plans. The average fee investors pay is considerably less, he said.

As recently as October, teachers' unions in central Florida urged teachers who had retirement questions to reach out to Mary L. Thomas, who was a consultant at the union-owned Creative Benefits for Educators. She wore two hats. She also had long been a sales representative at Valic, according to regulatory records.

After the Journal asked about her dual role, the Creative Benefits website went dark. Ron Sachs, a spokesman for the union-owned company, said in late October that it no longer employed Ms. Thomas and two other consultants. The salaries for the three were paid by Valic, according to documents from Valic and Creative Benefits.

Ms. Thomas didn't return messages seeking comment. Neither did Ms. Cannon, the union leader in Indian River County.

In teachers' 403(b) plans, annuities account for more than half of invested assets.

Annuities, largely sold by insurance companies, typically offer a pension-like lifetime income, but they can entail annual fees as high as 3% of invested assets.

Teacher David Hamblen said a recommendation by the National Education Association was a key reason he put 403(b) savings in an annuity before his 2010 retirement from the El Dorado Union High School District in Placerville, Calif.

The El Dorado Union High School District Office. **PHOTO:** MAX WHITTAKER FOR THE WALL STREET JOURNAL

The NEA is the nation's largest teachers union, with some three million members. "I thought that if they were recommending it, it must be a very good product," Mr. Hamblen said.

Around 2007, he read an article that mentioned payments an NEA affiliate received from an insurance company. With another public-schools employee, he sued the union, as well as insurance company Security Benefit Corp. and others. The suit, filed in federal court in the Western District of Washington in Tacoma, alleged that 403(b) participants were harmed by an arrangement in which the NEA and an affiliate endorsed high-cost investments from providers.

A for-profit subsidiary of the NEA received about $3.6 million from Security Benefit in the fiscal year ended Aug. 31, according to a document the subsidiary filed with the Securities and Exchange Commission. It shows the subsidiary, called NEA's Member Benefits Corp., could earn 5% to 10% more if certain undisclosed promotional goals were met.

NEA-affiliated state unions that referred members to Security Benefit products received $129,263 for the year, according to an SEC filing.

Among products Security Benefit sells to teachers belonging to the NEA is a variable annuity with expenses of up to 2.99% a year, plus up to 1.45% for optional features such as a death benefit.

A spokesman for Security Benefit, Michael Castino, said, “Most contract owners do not incur total costs that high.” He said the average contract owner pays about 1.95% a year.

Security Benefit also makes available an array of mutual funds, which carry fees of up to 2.19% a year. Investors in these have a choice of paying an upfront 5.5% commission or a 1% annual fee, says material published by Security Benefit.

Since 2007, Security Benefit has given NEA members an option to invest in relatively low-cost mutual funds from Vanguard Group Inc., T. Rowe Price Group Inc. and others. These are “no-load” funds, entailing no commissions that sales agents could earn.

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Should unions accept money for endorsing sometimes high-fee investment products for union members? Join the conversation below.

Lisa Sotir, chief compliance officer at the NEA’s Member Benefits subsidiary, said it recommends Security Benefit to union members in part because the insurer has a “trained field force” that can educate members on the importance of saving, which school districts may not provide.

Ms. Sotir said just 1.5% of the money in NEA-endorsed retirement products is invested in the low-cost option. She said many union members want investment guidance, which the low-cost-funds platform doesn’t offer.

For its own employees, the NEA hired low-cost Vanguard to oversee a 401(k), resulting in investment fees a fraction of what many NEA union members pay.

Asked why the difference, Ms. Sotir said the “NEA, like many private employers, offers certain levels of online education and advice.”

The NEA subsidiary doesn’t return any dividends, profits or royalties to the parent union, but uses the money to promote endorsed products and provide education and guidance to union members, Ms. Sotir said.

Mr. Hamblen in California lost his lawsuit challenging the NEA subsidiary’s deal with investment providers. A federal appeals court said the union and its subsidiary didn’t have a fiduciary obligation to make sure that fees on retirement-plan products were reasonable. Generally, public-school teachers’ 403(b) plans are exempt from federal pension law requiring 401(k)-plan sponsors to act in participants’ best interests.

Mr. Hamblen said he eventually sold his annuity, worth about $35,000, to cover bills. He was disappointed about how much of his savings went to fees, he said. Now 72, he continues working part time for the school district to make ends meet.

Teacher David Hamblen at his home in Diamond Springs, Calif. PHOTO: MAX WHITTAKER FOR THE WALL STREET JOURNAL

A Nationwide Mutual Insurance Co. subsidiary pays millions of dollars a year to organizations including the National Association of Counties, the International Association of Fire Fighters and the United States Conference of Mayors, or their affiliates, in return for endorsing retirement plans it administers for municipal workers, according to documents filed with regulators and local governments.

The Nationwide subsidiary paid $4.58 million to the National Association of Counties in 2017, the latest available data. About 1.6 million county employees and retirees have participated in 457 plans for which Nationwide is the record keeper, said Brian Namey, a spokesman for the county association.

He said the partnership doesn't guarantee Nationwide business: "They still have to compete" to win contracts. Nationwide offers plans with an array of investment options from many companies.

Steve Burdett, finance director at the Office of the Clerk of the Circuit Court in Brevard County, Fla., recalled being surprised a few years ago to learn on the internet about payments to the National Association of Counties for endorsements. "Employees are paying for those endorsements," he said.

Around 2012, Mr. Burdett began shopping for a better deal for the 320 employees and retirees of the office. In 2015, the office transferred $3.5 million of people's savings to a lower-cost 457 plan run by a different company, Massachusetts Mutual Life Insurance Co.

Nationwide spokesman Joe Case said the payments for endorsements are another way the company markets its retirement-plan services. He said public-sector employers are attracted by Nationwide's ability to deploy "extensive staffing" to educate workers about saving.

At the International Association of Fire Fighters, about 100,000 of the 292,000 members are in a Nationwide retirement plan, according to union President Harold Schaitberger. He said the union's for-profit subsidiary, called the International Association of Fire Fighters Financial Corp., earns $3.4 million a year for various product endorsements—$2.5 million of it from

Nationwide—and sends the parent union $2.45 million to support programs that benefit firefighters.

The Michigan Education Association union has a for-profit subsidiary that both endorses products and owns companies selling retirement investments to union members.

The union received $664,000 from this for-profit subsidiary, MEA Financial Services Inc., in the year ended Aug. 31, 2018. It said this represented reimbursement for items including rent and marketing help; the for-profit subsidiary doesn't provide dividends to the parent union, said union spokesman Doug Pratt.

Union members know they can trust the union and its subsidiary to provide quality, credible advice, Mr. Pratt said.

At the subsidiary-owned businesses that sell investments to union members—Paradigm Equities Inc. and Fairway Investment Group LLC—representatives use email addresses with the teachers' union's name. They share the union's East Lansing address. Some representatives are current or former teachers.

Trading on the union's name and hiring teachers is brilliant marketing, said Erik Klumpp, founder of Chessie Advisors LLC, a financial advisory firm in Rochester Hills, Mich. "If the sales agent is a fellow teacher you see in the halls, it's harder to call that person and say, 'I don't want to do business with you anymore.' "

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