

Miami-Dade Public School Teacher's Retirement Jeopardized by Slack Government Oversight

Would you buy an umbrella to only use inside?

Unfortunately, that is the equivalent of what many of Miami- Dade's public school teachers are doing with their retirement funds in their 403(b) plan.

Why would an otherwise intelligent teacher do such an illogical thing? There are a variety of reasons, but mostly it starts with the nature of 403(b) plans. These plans, known as tax-sheltered annuities (TSAs), are the equivalent to 401(k) plans for school districts and other non-profit organizations.

There are, however, important differences between a 403(b) and 401(k) that have resulted in teachers purchasing inappropriate investments for their 403(b) plans.

First, unlike many employers in 401(k) plans the public school districts make no matching contributions to what the teachers contribute in a 403(b). Therefore, the Miami-Dade Public School District, and school districts in general, does not recommend or make judgments about which companies have access to the teacher's funds.

Second, there is no "plan document" to govern the employer's (the school district) arrangement with vendors. That means there are no federal guidelines pertaining to: the appropriateness of investments offered, the costs of such investments or the administrative costs to run the plan, as there are with 401(k) plans.

This laissez-faire policy also results in no investor education being provided to the teachers.

A consequence of this lack of oversight results in unscrupulous insurance salesmen being allowed to roam the schoolhouse halls to sell their products. One teacher told me she and others were approached during their planning break, which is the only free time available during the day. The products sold by insurance salesmen are annuities (fixed and variable), which essentially combine a mutual fund with a life insurance benefit.

The problem is that it makes no sense putting a variable annuity into a teachers retirement account. The reason is that these products are very costly and their high cost benefits are unnecessary.

For example, the growth of a variable annuity investment is not taxed until it is sold-the tax deferral feature. However, a 403(b) plan because it is "qualified" already has tax-deferred status, so why would you pay more for a benefit you already have (like buying an umbrella to use indoors)? You wouldn't unless you didn't understand (lack of investor education for teachers) and were being sold (during your only free time) by a motivated salesman that the product was in your best interest. Furthermore, the insurance

feature, is not really insurance (though a mortality expense is charged), it simply guarantees that the teacher will receive at least what was invested. Securing true insurance coverage can better be accomplished (increased death benefit at lower cost) by purchasing term life insurance.

The flip side of the high cost of variable annuities to the teacher is that they are quite lucrative for the salesman. I have a client who had variable annuities in her 403(b) which carried annual expenses of 2.25% of her assets; the annual expenses of an index mutual fund are less than .25%. These higher expenses will erode returns and reduce the teacher's retirement nest egg. Yet such products pay the salesmen generous initial and ongoing fees which explain why fixed and variable annuities represent approximately 80% of assets in 403(b) plans, while traditional mutual funds represent only 15% of TSA assets. This contrasts with 401(k) plans where traditional mutual funds represent over 85% of assets.

Compounding the problem has been the relationship between insurance companies and some teachers unions. AIG Valic, an insurance company, rented space in union offices in California while ING, an insurance/financial services company, was fined \$100,000 for \$3 million in payments it made to the New York State United Teachers union. In return for these payments some unions have endorsed or given the impression that such products were in the best interests of their teachers. Unions in Dallas, Miami, Phoenix, Seattle and Atlanta, among others, refer members to products approved by the National Education Association and typically receive a share of endorsement revenue in return.

What to do?

Teachers need to demand better investment choices in their 403(b) plans. The American Federation of Teachers recommends teachers petition for new and better choices in their TSA accounts. Local unions can also make this an issue in future negotiations.

The government needs to enforce the same standards that ERISA (Employee Retirement Income Security Act, the legislation that governs 401(k) plans) requires of 401(k) plans on 403(b) plans including: a diversified choice of investments, appropriate costs for administering the plan (including investment costs) and investment education for teachers.

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