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Even Math Teachers Are at a Loss to Understand Annuities

By TARA SIEGEL BERNARD OCT. 28, 2016

Even a well-caffeinated person with an advanced degree in math would have a hard time deciphering a 53-page contract called “Your Flexible Premium Indexed and Declared Interest Deferred Annuity Policy.”

Melanie Panush Lindert, a 66-year-old elementary school dance teacher in Los Angeles, was sold one of these mind-numbingly complex products last year through her workplace retirement account. The same agent had sold her three other annuity contracts over the previous eight years, including another within her retirement savings plan — a so-called 403(b) — which is offered to employees of public schools, colleges, religious groups and nonprofits.

Annuities can be hard to fully grasp even in their simplest configuration, where you hand a pile of money to an insurance company, then receive a guaranteed stream of annual income for life. But schoolteachers and other people doing good works are often left to trudge through a morass of contracts tied to some of the most arcane investments, sold by representatives who may not fully understand the inner workings themselves.

“A lot of teachers are good rule followers,” said Tony Isola, a former history teacher turned financial planner who heads the 403(b) division at Ritholtz Wealth Management in New York. “The salesperson comes in, they are really nice and they sell them a bill of goods. And then they tell the other teachers.”

Ms. Lindert was following the lead of her sister, a fellow teacher. Her sister trusted the agent, who appears on the 68-page list of brokers working in the Los Angeles Unified School District. The recommendation seemed like a logical option to Ms. Lindert, who has a master's degree in dance but considers the world of finance entirely alien.

She took the agent's word over the years, including in 2015, when he told her to transfer her money from one so-called fixed indexed annuity, purchased in 2007 through the Life Insurance Company of the Southwest, to another, from the same insurer, to qualify for a bonus.

It "seemed like a good way to make more money," said Ms. Lindert, who started teaching when she was 53 and said she hoped to retire next year. For now, she teaches five classes a day, three days a week, to elementary schoolchildren at three schools. She brings her own speakers, drums, scarves and an iPod with 400 hours of music, along with a light lunch.

Ms. Lindert later found out that her purchase was also a good way for brokers to make more money. The first contract she was sold yielded an 11 percent commission, while the most recent pays another 7 percent to the broker, according to 2016 data from Wink AnnuitySpecs, an annuity analysis tool.

Certain types of annuities can serve as a useful retirement tool for some savers seeking a stream of guaranteed income. But many teachers already receive pensions providing a steady income base.

The type of annuity in Ms. Lindert's account, a so-called fixed index annuity, is particularly complex. In theory, these are appealing: They provide a guaranteed minimum interest rate; they let investors participate in the market's gains up to a certain ceiling; and they promise that buyers will not lose money when the market dives.

Ms. Lindert could have asked her fellow teachers in the math department for advice, though she probably would not have received any solid answers. When Patty Hill, an algebra teacher in Austin, looked over Ms. Lindert's latest contract from the

Life Insurance Company of the Southwest for The New York Times, she was just as befuddled. And downright angry.

“The document is filled with jargon, but at the same time, it is mathematically ambiguous,” said Ms. Hill, who recently received the Presidential Award for Excellence in Mathematics and Science Teaching, a prestigious award bestowed by the White House in August. “It is not being transparent there that is infuriating to me as a mathematician.”

Susan Jennings, senior counsel at the National Life Group, the annuity issuer’s parent company, defended its materials, saying she believed the interest rate methodology was laid out clearly. The insurer provided a copy of another disclosure — which she said agents give to all customers when they apply for the product — that is shorter and simpler, and together with the other documents, provides a more complete picture.

Still, how do investors know whether the product is appropriate for them?

Craig McCann, a former economist for the Securities and Exchange Commission, has built a computer model that is intended to make those calculations. He has employed close to a dozen people with Ph.D.s in math to dissect indexed annuity products as part of his firm’s work, which provides analyses for regulators and litigators representing investors. He said it took years for his team to master them.

“No agent selling these or investors buying these has the foggiest idea of how these work,” said Mr. McCann, who reviewed Ms. Lindert’s contracts.

But indexed annuities have to make sense for at least some investors, right? Perhaps for the incredibly risk averse? “No,” he said, without hesitation. “Never.”

Though it appears that investors have some exposure to the stock market, he says many are left with a return they could have achieved with a supersafe bond portfolio, without paying an obscured 2.5 to 3 percent annual fee charged by the annuity provider. “They are all Rube Goldberg machines,” he said.

In her case, Ms. Lindert was advised to annuitize her first contract — which paid a minimum interest rate of 3 percent — and direct the stream of income into the new annuity, which paid a minimum of 1 percent. The other investment options provided were also far less generous — shockingly so, Mr. McCann added. “This switch is really awful,” he said. “It’s really good for the insurance company. But it’s really bad for the investor.”

The new policy did include a so-called guaranteed lifetime withdrawal benefit — for an additional fee of 0.7 percent annually — which promises a certain level of lifetime income. But Mr. McCann said his analysis found that the new policy was still less valuable than the first.

Then, there’s the matter of surrender charges. Ms. Lindert would have owed a penalty for 15 years after signing her original contract — set on a sliding scale starting at 14 percent — if she wanted to withdraw more than 10 percent of her account’s “accumulation” value. The policy she bought last year, also issued by Life Insurance Company of the Southwest, has a nine-year surrender period, with a penalty fee starting at 8.25 percent.

Ms. Jennings of the National Life Group — who also serves on the National Tax-Deferred Savings Association’s government affairs committee — said that less expensive alternatives recommended by many financial planners did not meet the needs of risk-averse investors as well as annuities did. “Bond funds and portfolios do not guarantee principal,” she said, “and in a rising interest rate market can lose money.”

The American Council of Life Insurers, a trade group that represents annuity issuers and life insurers, echoed that point, noting that guarantees come at a cost so insurers can make good on their promises.

“Annuities are among the most highly regulated products,” Jack Dolan, a spokesman for the group, said, “with disclosure being a key consumer protection.”

The proliferation of annuities in 403(b) plans is largely a matter of history. When Congress introduced them in 1958, they were viewed as supplemental pensions for teachers, and the only permissible investments were annuities,

according to tax experts and consultants. The plans themselves, named for a section of the tax code, were called “tax-sheltered annuity arrangements.” Mutual funds were not available in 403(b) plans until 1974.

Slightly more than half of all 403(b) assets, approaching \$900 billion, have been invested in fixed annuities — which promise either a minimum rate of annual growth or interest based on changes in a market index. Another 25 percent were in variable annuities that invest in mutual funds, according to Investment Company Institute data as of March. The remaining 23 percent were invested in traditional mutual funds.

In contrast, about 60 percent of 401(k) assets, which totaled \$4.75 trillion, were invested in mutual funds, with only a small share in variable annuities. Despite the risks from short-term market declines, a diversified mix of stock and bond funds is generally less costly and provides a significantly greater return over time.

Ms. Lindert ultimately opted for mutual funds, after severing ties with her broker last year and meeting Steve Schullo, a retired teacher and 403(b) advocate. He told her about her district’s 457(b) plan, another type of tax-deferred account available to those who work for public schools and local governments.

Under that plan, run by TIAA, she has access to low-cost Vanguard funds. She chose to redirect her new contributions into one that invests up to 65 percent in bonds, with the remainder in stocks.

But most of her money is still tied up in four annuities that she does not understand.

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