Some of the biggest names in insurance peddle lousy retirement plans with high fees and low returns. One and a half million teachers blithely signed up for these dogs—often with their unions' blessing.

Teacher Michael Cangelosi wandered into the faculty lounge of his grade school in Derwood, Md. at lunchtime one day nine years ago, and a well-dressed man on the sofa beckoned to him with a plate of cookies and an offer of free advice.

The adviser was a salesman for AIG Valic, the largest vendor of retirement savings plans for teachers. He later whipped out colorful charts illustrating how Cangelosi, then in his mid-20s and with only a few thousand dollars saved, could avoid a trip to the poorhouse by setting up a tax-deferred teachers' retirement plan. A brochure, listing some mutual funds, touted no initial sales commissions and fees as low as $3.75 a quarter.

Sold: In the next eight years Cangelosi put $14,200 into his retirement plan. Belatedly, last summer he addressed the question of whether he was doing as he hoped. By the time he bailed out and paid a $500 kill fee, he ended up with all of $13,655—$550 less than what he had invested over all those years. Why? One big reason was that he had been paying fees of 2% a year, two to three times the rate charged by big mutual funds. This during a time when a low-cost S&P Index fund would have returned 95%.

"It was a stinging feeling to realize that, for eight years, I could have been paying so much less for better investments," says Cangelosi. He has since switched his faltering retirement plan to TIAA-CREF, the giant investment firm set up for educators—for what he says is only one-fifth the annual AIG fees.

Cangelosi was attracted by the idea of investing in mutual funds but in fact had been lured into buying an insurance plan that can best be described as a coals-to-Newcastle investment. The AIGValic agent had sold the teacher a variable annuity, a basket of half a dozen mutual funds wrapped in a life insurance policy.

This type of insurance doesn't pay your surviving family a million-dollar jackpot if you die suddenly—it promises only to pay back the money you had put into it, plus any extra returns it earned. The main appeal of variable annuities is their tax deferral, yet Cangelosi already had that in his retirement plan. The main downside to annuities is stiff fees, often 2% or 3% a year. AIG Valic says it has revised its sales literature to more accurately portray the product.

Yet roughly 1.5 million teachers at the nation's public schools have put their retirement savings into insurance plans, for a total $120 billion in assets. The business is stoked by some of the biggest names in insurance: AIG, the world's largest insurer; ING; AXA; and MetLife. Some firms pay first-year commissions as high as 9% to agents, who troll school campuses for prospects.

"School districts don't provide education [about retirement accounts]," says Daniel Otter, a teacher and operator of a Web site, 403bwise.com. "So the first time most teachers hear of them is when a salesman shows up in the lounge selling annuities larded with high fees and surrender charges."

Teachers unions are complicit partners in this dubious pursuit. Insurers cut murky deals with labor unions to buy exclusive access to their members, sometimes paying the unions millions of dollars in fees in exchange for the unions' endorsement of their annuity plans. Invariably this foists on teachers some of the most expensive annuity products around.

"Unions play a very large role in teachers' decision making," says Michael Beczkowski, a consultant with Bolton Partners who evaluates retirement plans for school districts. "Some companies offering these plans make large union donations, so it's very difficult to get rid of them even if their products are substandard. The participants pay for it."