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**Submission to the Parliamentary Committee on Corporations and Financial Services
'Inquiry into the Structure and Operation of the Superannuation Industry'**

INTRODUCTION

The Association of Independent Retirees (A.I.R.) Limited welcomes the Inquiry into the Structure and Operation of the Superannuation Industry. The Association is the peak body representing the views of fully and partly self-funded retirees with over 15,000 members Australia wide. The Association's policies endeavour to achieve dignity, independence, and freedom of choice for retirees, recognising a diverse range of individual circumstances.

A.I.R. believes that three criteria are important in determining government policy on retirement incomes. These are consistency, simplicity, and good law.

A substantial proportion of retirees' retirement assets are held in Superannuation. Many members have had contributions made by employers into substantial size superannuation funds. They have little understanding of the issues involved in the structure and operation of the superannuation industry because they see this only at third hand. However, they expect to have confidence in the industry and expect operators to be suitably qualified and of good character. They expect the industry to be regulated and monitored in an efficient and effective manner. Within this expectation, this submission addresses aspects of the Terms of Reference of particular interest to A.I.R. members.

A substantial proportion of superannuation funds are held in Self Managed Superannuation Funds (SMSFs). These funds form a substantial part of the Superannuation Industry together with the large support base of accountants, auditors and actuaries.

The relationship between an SMSF and its trustees contrasts with that between retirees and large superannuation providers because members/trustees are directly involved in decision making, administration and investment. Consequently, the issues arising in SMSFs are more transparent to retirees and to A.I.R. members. This submission has an emphasis on an efficient, effective and safe regulatory structure for the management of that portion of the superannuation industry represented by SMSFs.

SUMMARY OF RECOMMENDATIONS

Item 1 Recommendations

- 1.1 The same capital requirements should apply to all superannuation funds where the members are at arms length from the decision-making process.

Item 2 Recommendations.

- 2.1 APRA and other appropriate bodies support and encourage the formation of corporate trustees in SMSFs having more than two member/trustees.

- 2.2 Duplication of regulation of corporate trustee SMSFs be removed with a consequent reduction in compliance costs.
- 2.3 A review of regulation of SMSFs be conducted to determine the single most appropriate body for regulation of these funds.
- 2.4 The number of member/trustees of an SMSF be defined by ‘directly related parties’ and the artificial number of four be removed

Recommendation 3.

- 3.1 A review of APRA, ASIC and ATO be conducted to reduce duplication of roles and responsibilities and to bring all regulation of the superannuation industry under ASIC, with its enforcing powers.

Item 4 Recommendations

- 4.1 The degree of regulation on the financial advice/planning sector of the industry is adequate. The need is to improve its cost-effectiveness and transparency.
- 4.2 There should be no regulation on the fee structure for financial advice/planning except that trailing commissions or similar techniques should be banned by legislation. Market forces should be allowed to dictate the fee structure.

Item 7 Recommendations

- 7.1 SMSFs continue to be encouraged.
- 7.2 Administration and regulation of SMSFs be simplified as set out under Item 9.

Item 9 Recommendations

- 9.1 Redesign ATO lodgement forms to:
 - a. remove all unnecessary data
 - b. make them easier to complete without error
 - c. add declaratory statements requiring trustees to sign off that they have invested funds in accordance with the legislation, consistent with those presently required by auditors.
- 9.2 Emphasize the training of accountants using the proposed audit compliance check list.
- 9.3 Require all new SMSFs (initially all SMSFs) to be audited by an approved independent auditor for a period of three years. Where the accounts are prepared by a qualified and trained accountant during the three year period and there are no audit non-compliance reports for the fund, then further auditing should not required provided that accounts continue to be prepared by an approved qualified and trained accountant. Where an SMSF is found to be in breach by the ATO, then that SMSF should be required to be audited by an approved independent auditor for a lengthy period established by the ATO thereafter.
- 9.4 Provide a seeding grant to investigate a mechanism for accrediting accountants and auditors working with SMSFs

Item 12 Recommendations

- 12.1 Clarification of the concepts “not for profit” and “All profit goes to members” is unnecessary.

Item 13 Recommendations

- 13.1 Any comparison or benchmarking of the Australian superannuation industry with overseas industries should be made public and available widely for comment.

Item 14 Recommendations

- 14.1 Government regulatory bodies should be held responsible for any failure of large superannuation providers and any compensation should be a cost to government.
14.2 There is no case for establishing any compensation scheme for failure of SMSFs.

SUBMISSION

Comments on those particular items in the Terms of Reference of direct concern to A.I.R. members follow.

Item 1 Whether uniform capital requirements should apply to trustees

The same capital requirements should apply to all superannuation funds except SMSFs. Forms of funds which are “not for profit” should not be exempt. The principle should be that funds where the members are at arms length from the decision-making process should have capital requirement safeguards to protect the interests of members. SMSFs, including those established using a Corporate Trustee, should not be included because the nature of an SMSF requires all member/trustees to be involved in the decision-making process.

Item 1 Recommendations

- 1.1 The same capital requirements should apply to all superannuation funds where the members are at arms length from the decision-making process.

Item 2. Whether all trustees should be required to be public companies.

The position of trustee carries with it specific responsibilities, for example, ensuring that the operation of the superannuation pension fund is in accordance with its Trust Deed and that the Trust Deed complies with legislative requirements, estate beneficiaries receive their correct entitlements, etc. Traditionally the trustee was a qualified entity at arms length from both the superannuant, the fund manager, and if applicable the fund custodian. This ensured independence of scrutiny, action, and avoidance of any conflict of interest. A.I.R. supports the view that these responsibilities are best handled by an independent public company where a substantial number of independent superannuants entrust their funds to the Trust.

All members of SMSFs are required to be Trustees and to hold assets in their names. This is partly a compliance requirement to ensure that members understand their asset commitments and partly a consequence of the nature of Trusts. At present an SMSF may have up to four members/trustees. An alternative structure is to establish a corporate trustee for an SMSF.

The structure where all members are trustees and the trust is established outside a corporate structure is the most common. However, the linked ownership/trustee requirement is extremely complicated and inefficient. The cost of adding or removing a trustee is very high. Significant costs are involved in transferring assets to a new name (an addition or removal of a trustee from the ownership of the asset) even though the name of the Trust remains the same. New Direct Debit notices are necessary for all assets. All member/trustees are required to sign many documents, which is costly and time consuming when member/trustees are interstate or overseas. The name of the asset, eg: bank account, property or equity, becomes extremely lengthy and difficult for the service organisation to manage. The cost of changing ownership is high, not only for the fund, but also for the organizations administering the assets.

The alternative of establishing a corporate trustee is costly. Few member/trustees are aware that such a facility can remove the administrative complexity. Worse, compliance involves both the Australian Prudential Regulation Authority (APRA) and the Australian Taxation Office (ATO). Additional fees are involved because of this duplication.

There is no taxation of assets during the drawdown phase. As the population ages and more people become involved in superannuation the proportion of people in the drawdown phase will increase significantly. This is reinforced in the Plan to Simplify and Streamline Superannuation recently announced by the government. This means that taxation of superannuation funds is limited to the accumulation of assets.

The compliance structure of the ATO in general taxation collection is one of self assessment. The control environment introduced by the ATO for SMSFs is conceptually different from the self-assessment environment of its normal operation. In the light of the structural changes to superannuation there is a serious question as to whether or not the ATO is the appropriate body to regulate SMSFs, particularly when there is duplication of administration of corporate trustees between APRA and the ATO.

Four members/trustees of an SMSF are the maximum allowed. This is an artificial figure which bears no relationship to the objectives of the government—namely to provide a mechanism for interested family members to manage their superannuation assets. A.I.R. believes that the number of members of an SMSF should be flexible to allow all related parties to be members. For example, one family might have three sons/daughters as well as the mother and father. All are interested in investing their own funds in an SMSF. In addition, the sons/daughters are interested in assisting the mother and father to manage their affairs as they become older. The present rules prevent this, causing family problems because one party must be left out.

A.I.R. believes that the number of member/trustees should be restricted to the number of directly related persons with an interest in investing in superannuation through the SMSF in their own right. It can understand that some limit may be necessary but believes that this should be determined by definition of a ‘directly related’ party rather than by an artificial number.

The difficulties arising from the ownership of assets by all member/trustees are compounded when the number of member/trustees is increased. A.I.R. does not believe that this should be a reason for preventing bonafide people from becoming members/trustees of a SMSF, but believes that this reinforces the need to support a corporate structure with a single regulatory control.

Item 2 Recommendations.

- 2.1 APRA and other appropriate bodies support and encourage the formation of corporate trustees in SMSFs having more than two member/trustees.
- 2.2 Duplication of regulation of corporate trustee SMSFs be removed with a consequent reduction in compliance costs.
- 2.3 A review of regulation of SMSFs be conducted to determine the single most appropriate body for regulation of these funds.
- 2.4 The number of member/trustees of an SMSF be defined by ‘directly related parties’ and the artificial number of four be removed.

Item 3. The relevance of Australian Prudential Regulation Authority standards.

A.I.R. members are very concerned over the recent Westpoint scandal. They question whether APRA carried out its legislative responsibility properly.

There are two questions: were the regulatory requirements under the legislation sufficient, and did APRA carry out its responsibility adequately?

This raises the issue of the adequacy of the regulatory systems operating to regulate the financial industry in general. There is overlap between the roles of ASIC and APRA. ASIC is established under legislation that gives it a clear enforcing role as well as a regulatory role. Its recent action against AMP illustrates its enforcing role. The enforcing role of APRA is not clear. A.I.R. proposes that there should be a review of APRA and ASIC to determine if APRA should be integrated into ASIC.

Regulation of the SMSF sector is carried out by the ATO. The appropriateness of this is questioned under Item 2 in this submission where the future structure of SMSFs is discussed. A.I.R. proposes that a review of the regulatory process applying to the superannuation industry should be carried out with a view of removing duplication of regulation on all sectors of the industry.

Recommendation 3. The relevance of Australian Prudential Regulation Authority standards.

- 3.1 A review of APRA, ASIC and ATO be conducted to reduce duplication of roles and responsibilities and to bring all regulation of the superannuation industry under ASIC, with its enforcing powers.

Item 4. The role of advice in superannuation.

The role of advice in superannuation should be:

- to assist younger people to make investment choices for accumulating assets for their retirement years,
- to assist people with superannuation assets to choose between superannuation funds, including SMSFs
- to assist retirees and those planning retirement to make effective choices for the efficient drawdown of their assets.

It is acknowledged widely amongst A.I.R. members that the quality and cost of financial advice, including superannuation advice, is unsatisfactory. The advice is often

inaccurate and not always impartial. The reputation of the financial advice industry is very poor.

Advice provided should without fail, always be in line with an individual's short, medium and long term objectives. Advice should from the outset be aimed at providing value beyond what an individual could have otherwise achieved. Advice should always be initially focused on structures and operational efficiency, prior to any discussions on investments such as managed funds or shares, i.e. once an individual's structure is correct (handling/disposing and holding wealth) discussion can then begin involving underlying investments.

The majority of financial advisers/planners work are employed by or are related to major providers of financial products (e.g. banks, stockbrokers, insurance companies). Therefore, the responsibility for proper behaviour should rest with the providers of financial products.

Competition is strong. Consequently, providers have an incentive to build strong brands and reputations to attract customers. They cannot afford actions such as the AMP/ASIC action because of the negative effect on their reputations. An effective regulatory body such as ASIC will strengthen providers' resolve to have their advisers/planners act credibly.

Conditions for conflict of interest exist whenever fund managers offer commissions and other types of remuneration payments to financial advisers/planners who recommend their products. Independent financial advice is only likely to be achieved if all remuneration for financial advice comes exclusively from the person seeking the advice. However, some clients seek a wide range of advice to assist in making the best decisions. They would prefer to pay when that decision has been made and prefer a commission structure. Providers will always try to meet market needs. They should be permitted to adopt a fee structure that best meets their needs (either fee-for-service or commission or both). However, trailing commissions should be banned by legislation.

Government and Professional Association efforts to improve the expertise of financial advisers/planners are welcomed by A.I.R. members. They take the view that continuing education and upgrading of expertise are prime factors in raising the reputation of financial advisers/planners.

Reputation of the financial advice/planning industry and confidence by consumers will be improved from its present very low level as government regulation is seen to be effective and as the quality of advice is seen to be improved through higher quality education and compulsory continuing education programs.

Item 4 Recommendations

- 4.1 The degree of regulation on the financial advice/planning sector of the industry is adequate. The need is to improve its cost-effectiveness and transparency.
- 4.2 There should be no regulation on the fee structure for financial advice/planning except that trailing commissions or similar techniques should be banned by legislation. Market forces should be allowed to dictate the fee structure.

Item 7 The reasons for the growth in SMSFs

The predominant reason for the growth in SMSFs is the desire of people to manage their own investments. A secondary reason is dissatisfaction with large funds—lack of transparency on matters such as fees, lack of flexibility in managing their own funds, and complexity. A further reason is the increasing interest in superannuation from self employed persons who have not accumulated investments through deducted employer amounts.

Despite increasing complexity in the regulation of SMSFs the desire to control ones own affairs out ways these complexities. However, increasing complexity has led to considerable interest by member/trustee members of A.I.R. to seek better regulatory arrangements with government.

Item 7 Recommendations

7.1 SMSFs continue to be encouraged.

7.2 Administration and regulation of SMSFs be simplified as set out under Item 9.

Item 9 Cost of compliance

A.I.R. seeks an SMSF compliance system which:

- achieves effective compliance to meet the requirements of the Act,
- is limited to the compliance requirements under the Act,
- is cost-effective for SMSFs and for the ATO as the regulator,
- avoids duplication in reporting,
- allows information for statistical purposes to be gathered efficiently.

Full compliance reporting was introduced by the ATO for the 2004/2005 Financial Year. Compliance checking consists of:

- compulsory independent auditing of all individual SMSFs.
- reporting of breaches by auditors that can attract penalties
- checking fund income tax and regulatory returns
- auditing of ‘at-risk’ funds by the ATO—3,600 in 2005/2006 or 1.2% of total funds.

Outcomes of the compliance program that have been released to date show that:

1. Of 9,600 approved auditors identified from tax returns, 40% reviewed one fund per year and a further 30% reviewed between two and five funds. The ATO has serious concerns about the quality of the compliance audit component¹. The ATO is working with the professional accounting associations to increase the use of audit check lists. Twenty ‘high-risk’ auditors are presently being reviewed and another 200 will be reviewed over the coming year².
2. Auditors sent in 5,000 auditor contravention reports. The total number of funds is 300,000. The contravention reports comprised:
 - assets not in the name of the fund 18% (90 funds) or 0.03% of all SMSFs
 - loans to members or relatives 17% (85 funds) or 0.03% of all SMSFs
 - inhouse asset breaches 13% (65 funds) or 0.02% of all SMSFs
 - borrowing by the fund for purposes not allowed 11% (55 funds) or 0.02% of all SMSFs

¹ Ian Read, Assistant Deputy Commissioner of Taxation, 4 November 2005. Address to Taxpayers Australia.

² Michael D’Ascenzo, Commissioner of Taxation, 1 March 2006. Address to the National SPAA Conference.

- breach of the sole purpose test 7% (35 funds) or 0.01% of all SMSFs³.
- The total number of funds involved may be less than the above figures because it is likely that an individual fund may have contravened in more than one of the above matters. It is to be noted that 12% of contravention reports were for documents requested by auditors but not supplied—an administrative breach.
3. Over 30,000 funds have been sent letters for non-compliance in lodgement of income tax and regulatory returns. Three thousand of these are being pursued. Typical errors detected include:
 - ticking the non-complying box when the fund is complying
 - establishment dates differing from registration dates
 - transposing labels recording the number of fund members and total investments in the fund
 - incorrectly stating that an approved auditor has conducted an audit⁴. This may be a deliberate breach of the legislation but is the only one of the above in this category.
 4. There are about the same number of funds (about 1% of the total) being investigated by the ATO as have been reported by auditors for non-compliance. The information as to whether or not these were identified from the non-compliance reports or whether they have been independently identified is not available. It would be useful to establish the relationship between ATO activities and auditor non-compliance reports.

The information above demonstrates:

- that a very small percentage of SMSFs contravene the SIS Act and Regulations in matters that affect the financial viability and superannuation purposes of the fund,
- generally the ATO is pursuing these funds,
- the degree to which auditor non-compliance reports have led to identification of the “high-risk” funds is not available,
- in general, auditors are not meeting the requirements of the ATO,
- most lodgement errors are of an administrative nature and do not affect the financial viability and superannuation purposes of the fund.

High quality independent auditors have established audit compliance check lists. They have placed a heavy emphasis on training accountants to provide the information they require (one gives a star rating to accountants for their reporting). It is probably true that where an auditor only audits a few funds, the accountant only prepares a small number of SMSF accounts. Hence, from the ATOs point of view, the training problem is as significant for accountants as it is for auditors.

From the point of view of SMSF trustees it would be better to place the emphasis on training accountants. Trained accountants would make it easier for trustees to meet their obligations and would increase confidence between trustees and their accountants. It is a legal obligation that trustees sign off accounts and it is the responsibility for accountants to

³ Ian Read, Assistant Deputy Commissioner of Taxation, 4 November 2005. Address to Taxpayers Australia.

⁴ Raelene Vivian, Deputy Commissioner of Taxation, 3 March 2006. Address to the National SPAA Conference.

prepare accounts in accordance with the requirements of legislation. A trustee signing off accounts before they are presented to an auditor (the normal practice) is in breach of the legislation if the auditor finds fault with the accounts. For this reason it would be far preferable to concentrate on educating accountants.

Many aspects of compliance cannot be independently and readily checked by an auditor. These aspects are dealt with by requiring trustees to sign declarations that they meet the requirements of the legislation. Auditors require accountants to have these declarations completed by trustees. There is no reason why the accountant cannot be required to obtain these declarations in the first place without placing the onus on the auditor to obtain them through the accountant.

Because of the greater knowledge that an accountant has of the affairs of an SMSF, it is far more likely that an accountant can identify improper application of funds than can an auditor.

AIR proposes that emphasis should be placed on training accountants using the proposed audit compliance check list.

It further proposes that all new SMSFs (initially all SMSFs) be audited by an approved independent auditor for a period of three years. Where the accounts are prepared by a qualified and trained accountant during the three year period and there are no audit non-compliance reports for the fund, then further auditing should not be required provided that accounts continue to be prepared by an approved qualified and trained accountant. Where an SMSF is found to be in breach by the ATO, then that SMSF should be required to be audited by an approved independent auditor for a lengthy period established by the ATO thereafter.

Many of the breaches in lodgement compliance referred to above can be traced to bad design of the regulatory returns. For example, the requirement to enter the date of establishment each year simply leads to the opportunity for error. It takes time for a trustee to have to search through documents to find the date. It serves no purpose because the ATO has the information already. The requirement should be for notification of any changes to the Trust, including trustees. Another example is that the ATO requires an industry category to be completed by a retired person. Again, transposing data in a return suggests that the design is bad.

Redesign of the regulatory returns would allow revision of the data collected to match a set of statistics agreed by the industry, the ATO, and trustees. For example, the ATO quotes much greater costs of administration of funds than is quoted in the latest IFSA survey. The reason is that the ATO includes investment costs, whereas the IFSA survey is related directly to fund administrative costs. Agreement on the data to be collected would be of considerable advantage to all stakeholders.

A.I.R. proposes that ATO lodgement forms should be redesigned to:

- d. remove all unnecessary data
- e. make them easier to complete without error
- f. add declaratory statements requiring trustees to sign off that they have invested funds in accordance with the legislation, consistent with those presently required by auditors.

The estimated cost of independently auditing all SMSFs is of the order of \$120 million per year. A process that achieves a satisfactory degree of compliance and reduces

these costs is important from the point of view of both trustees and government. The accumulated loss from inefficient administrative costs over a number of years of operation of an SMSF becomes very considerable and affects the eventual cost to government of supporting retirees.

The ATO Regulatory Return requires that the auditor's professional association and membership number be listed. The only effective control it has over accountant and auditor performance is through action following identification of SMSFs in breach of the legislation. The quality of compliance would be greatly improved if the performance of many auditors and accountants was improved. This could be achieved through development of education and training materials, providing standard systems including annual reporting standards and compliance check lists, and providing regular updating material. Accreditation through an appropriate accrediting body responsible for the development and provision of such materials would ensure that recommended systems were used and accountants and auditors maintained their knowledge through continuing education.

ASIC has supported accreditation in principle but does not believe it is its role to set up an accrediting body. A similar situation arises with the ATO. It is unlikely that the peak accounting bodies would support accreditation or establish an accrediting body. An accrediting body would need to have the following characteristics:

- Seen to be independent of any professional bodies. A.I.R., as an association representing consumers would be seen as independent by trustees. Involvement of appropriate bodies such as the Small Independent Superannuation Funds Association (SISFA) could provide professional credibility.
- An independent accrediting body would need to be self supporting by charging accreditation fees.
 - A.I.R. and SISFA may not have sufficient financial resources to establish such a body. It may be possible to obtain a grant from government for its establishment.
 - An alternative could be to investigate any interest by the Standards Association of Australia—now a publicly listed company.

Public support for accredited accountants and auditors would be provided through A.I.R., the accrediting body, the regulatory bodies and appropriate professional associations. Such support would provide a powerful incentive for accountants and auditors to become accredited.

- Accreditation could be for three years because of the rapidly changing nature of superannuation. Evidence of the use of standard systems and of annual study would be required to remain accredited. Any serious proven ATO breach would automatically lead to removal of accreditation.

Item 9 Recommendations

- 9.1 Redesign ATO lodgement forms to:
 - g. remove all unnecessary data
 - h. make them easier to complete without error
 - i. add declaratory statements requiring trustees to sign off that they have invested funds in accordance with the legislation, consistent with those presently required by auditors.
- 9.2 Emphasize training of accountants using the proposed audit compliance check list.

- 9.3 Require all new SMSFs (initially all SMSFs) to be audited by an approved independent auditor for a period of three years. Where the accounts are prepared by a qualified and trained accountant during the three year period and there are no audit non-compliance reports for the fund, then further auditing should not be required provided that accounts continue to be prepared by an approved qualified and trained accountant. Where an SMSF is found to be in breach by the ATO, then that SMSF should be required to be audited by an approved independent auditor for a lengthy period established by the ATO thereafter.
- 9.4 Provide a seeding grant to investigate a mechanism for accrediting accountants and auditors working with SMSFs

Item 12. The meaning of the concepts “not for profit” and “All profit goes to members”.

These two terms are widely used and well understood. They confirm that the company is owned exclusively by its members and not by shareholders, and therefore is not subject to the pressures of sharemarket fluctuations.

Item 12 Recommendations

- 12.1 Clarification of the concepts “not for profit” and “All profit goes to members” is unnecessary.

Item 13 Benchmarking Australia against international practice and experience

Australian government retirement policy is outstanding by world standards. Policy development is dynamic because retirement policy is relatively new and experience continues to identify areas of change.

A.I.R. believes that Australia is well in front of many countries and strongly supports the recent policy approaches of government.

A.I.R. has insufficient knowledge of the corporate superannuation provision internationally to comment on the need to benchmark against other countries. It understands that the SMSF structure is unique to Australia. If there are other similar systems then any comparison or benchmarking should be made public and available widely for comment.

Item 13 Recommendations

- 13.1 Any comparison or benchmarking of the Australian superannuation industry with overseas industries should be made public and available widely for comment.

Item 14 Level of compensation in the event of theft, fraud and employer insolvency

Government has established a strong enforcing and regulatory structure through ASIC. APRA does not have the same enforcing capability. Both are responsible to government for administering its legislation. Conversely government is responsible for ASIC and APRA performing their regulatory roles within the legislation. Failure by the regulatory bodies to properly regulate large superannuation providers should rest with the government. Otherwise the purpose of establishing the regulatory bodies and their costs on the industry cannot be justified. A.I.R. does not support a concept where regulation is seen

as a best effort with no responsibility for failure. Consequently, it does not support any structure which would impose additional insurance costs, and hence less effective returns to retirees, against failure of large superannuation providers. It proposes that the risk of failure of a regulated provider would be reduced if APRA was merged into ASIC, with its enforcing and regulatory role.

There is no compensation available to SMSFs, which many industry players regard as being under greater risk of failure than large superannuation providers. If insurance against failure of a large superannuation provider, effectively insurance against failure of the regulator to carry out its role, is considered then there is a greater argument for compensation for SMSFs.

Item 14 Recommendations

- 14.1 Government regulatory bodies should be held responsible for any failure of large superannuation providers and any compensation should be a cost to government.
- 14.2 There is no case for establishing any compensation scheme for failure of SMSFs.

End of submission