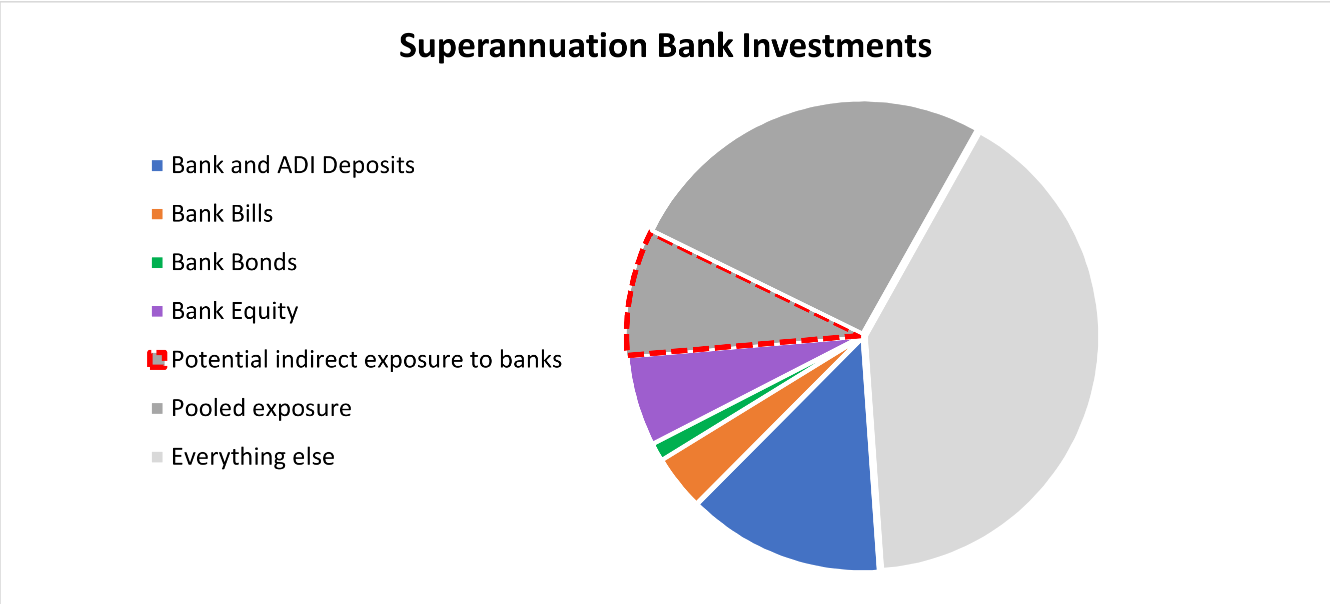
Can't get enough banks

Given yesterday's credit watch rating announcements for Australia and the big four banks – it is timely to look at the superannuation sector's aggregate bank exposure. Australian investors won't be surprised that the big-4 banks are Australian superannuation fund's largest exposure – but they might be surprised how large that exposure is. While the Big 4 banks are separate companies – with different exposures, strengths and weaknesses – from an asset allocation perspective it is probably worth thinking of them as a single exposure. Their share price performance will be dominated by the same key macro factors.

ABS data for March 2016 show direct bank equity exposure across the superannuation sector (both SMSFs and APRA regulated funds) of $120 billion – or more than 6% of total superannuation assets. And perversely this is the good news – it's down $13 billion from a year ago – probably due to price falls rather share sales.

In addition, superannuation funds hold $263 billion of deposits, $73 billion of bank bills and $24 billion of bank issued bonds, for a total exposure to the banks of $481 billion or around 25% of total superannuation system assets.

These are the identifiable exposures. In addition, funds have a further $670 billion of investments via wholesale and retail pooled unit trusts as well as life funds – which in turn are likely to have significant bank exposures. If these exposures are in line with the balance of their investments (or for that matter Australian equity index weightings) this implies a further ~$160 billion of exposure. That would take total look through exposure to the banking sector of around $650 billion or more than a third of system assets!



There is likely to be a big difference in bank exposure between SMSF vs large funds. SMSFs have lower overseas equity holdings within their total equity exposure – this will tend to push up their exposure to banks. In addition, SMSFs are aggressive users of term deposits (instead of more traditional fixed income) and this will push up their exposure as well.

In some ways, it is not surprising that superannuation funds are highly exposed to the largest intermediaries in the Australian financial system. The question it raises is whether large funds would be best served by getting some of their exposures more directly (i.e. disintermediating the banks). This would have diversification benefits, whilst at the same time delivering the inherent return/cost/risk benefits of investing more directly.