

Research Update:

# IBG LLC And Subsidiary Interactive Brokers LLC Ratings Affirmed; Outlook Remains Positive

March 30, 2020

## Overview

- While the Federal Reserve's lowering of the federal funds rate will hurt IBG's profitability, we expect it to remain more than satisfactory to support current ratings.
- As a result, we are affirming our 'BBB' issuer credit rating on IBG LLC and our 'BBB+' long-term and 'A-2' short-term issuer credit ratings on its core U.S. brokerage subsidiary, Interactive Brokers LLC.
- The positive outlook continues to reflect our view that growth of less confidence-sensitive brokerage clients and shrinking market-making business could reduce the firm's risk and bolster its business and financial stability, even in the face of recent challenging conditions.

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## Rating Action

On March 30, 2020, S&P Global Ratings affirmed its 'BBB' issuer credit rating on IBG LLC and its 'BBB+' long-term and 'A-2' short-term issuer credit ratings on Interactive Brokers LLC. The outlook remains positive.

## Rationale

The rating action reflects that while the recent cuts in the fed funds rate will decrease net interest income, we expect the firm's profitability to be less affected than peers' and to remain solid, with pretax margins remaining well above 40%.

We expect IBG's profitability to hold up better than many retail brokerage peers because IBG's pre-tax profit margin of over 65% the last two years give it the ability to absorb a decline in revenue and because it is less exposed to lower interest rates. This is because IBG passes on to clients a significant portion of what it earns on their uninvested cash balances and gets significant interest income from margin loans. Overall, we estimate the impact of zero short-term interest rates on net earnings to be about 12%-13%. Likewise, unlike its discount brokerage peers, IBG still charges commissions on the majority of its trades (and benefits from the recent surge in customers' trading volume) or earns offsetting revenue on its zero-commission offering. Also

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unlike many retail brokerage peers, IBG's earnings have not been hurt by the decline in equity markets because it does not have material asset-based fee accounts.

While volatile markets could increase losses on margin loans, the firm has substantial excess capital to absorb losses, given that its cushion above that necessary to maintain a risk-adjusted capital (RAC) ratio above our 15% threshold for the current rating is almost \$4 billion.

Our ratings on IBG and its subsidiary, Interactive Brokers LLC continue to reflect the consolidated firm's solid market position, very strong capitalization, good earnings, and adequate funding and liquidity. We believe model and operational risks and the highly competitive and transactional nature of the firm's businesses will continue to at least partly offset these strengths.

IBG is a holding company that, through its regulated broker-dealer subsidiaries, is a major global electronic broker serving both retail and institutional clients. We believe IBG's market position and profitability benefit from its technology-enabled, low-cost provider status, which supports unique, low-cost, and high-functionality offerings. While the firm's brokerage has been the leader in daily average revenue trades, it is substantially smaller than its main retail peers in terms of total client assets, with \$167.3 billion as of November 2019.

IBG continues to grow its retail, financial adviser, and other stickier client bases, but unlike its peers, it has more institutional trading clients, which we view as more confidence-sensitive. However, these clients are also more likely to continue to trade in the volatile markets we've seen recently.

The continued wind-down of IBG's options market-making business has reduced its footprint on the balance sheet and its exposure to market risk, model-driven trading operational risk, and funding risk. Continued run-off of trading assets has lowered value-at-risk and market risk risk-weighted assets, which has supported a RAC ratio above 36% despite the growth of the brokerage business. That said, we believe IBG's continued market-making operations to support its brokerage business and international market-making in profitable locations globally leave some market and operational risk.

## Outlook

The positive outlook on IBG LLC reflects our view that growth of less confidence-sensitive brokerage clients and shrinking market-making business could reduce the firm's risk and bolster its business and financial stability, even in the face of challenging recent market, interest rate, and economic conditions. We expect the firm will maintain its RAC ratio well above 25%, gross stable funding ratio in excess of 110%, and a liquidity coverage metric above 90%.

## Upside scenario

Over the next 12-24 months, we could raise the ratings on IBG if:

- We expect market and economic conditions to normalize;
- The firm's new zero-commission pricing option does not materially erode profitability;
- Its portion of more stable and less confidence-sensitive retail and financial adviser clients grows to provide improved diversification and stability;
- It remains committed to holding very strong levels of capital and successfully manages its margin loan exposures with minimal losses; and
- Its options market-making risk runs down materially.

## Downside scenario

Over the same time horizon, we could revise the outlook to stable if we expect the firm's RAC ratio to weaken to below 20%, or if its business displays less stability, higher risk, or losses and a material decline in liquidity.

## Ratings Score Snapshot

### Ratings Score Snapshot--IBG LLC And Interactive Brokers LLC

IBG issuer credit rating	BBB/Positive/--
Interactive Brokers LLC issuer credit rating	BBB+/Positive/A-2
GCP	bbb+
Anchor	bbb-
Business position	Adequate (0)
Capital and earnings	Very Strong (+2)
Risk position	Adequate (0)
Funding and liquidity	Adequate/ Adequate-High (0)
Comparable ratings adjustment	0
External influence	-1
Government influence	0
Group influence	-1
Rating above the sovereign	0

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

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### Ratings Affirmed

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#### IBG LLC

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Issuer Credit Rating BBB/Positive/--

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#### Interactive Brokers LLC

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Issuer Credit Rating BBB+/Positive/A-2

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