S&P Global Ratings

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IBG LLC

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IBG LLC

Ratings Score Snapshot

Issuer Credit Rating
BBB+/Stable/--

SACP: a- → **Support: 0** → **Additional factors: -1**

Anchor	bbb-	
Business position	Adequate	0
Capital and earnings	Very strong	+2
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		+1

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Holding company ICR
BBB+/Stable/--

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Very strong capitalization	Some operational risk from complex, model-driven options market-making business
Modest risk appetite	Sensitivity to change in brokerage customers' confidence
Geographic growth	Lower recurring revenue than some peers
Low-cost brokerage business	

Our ratings on IBG and subsidiary Interactive Brokers reflect the firm's strong market position, strong capitalization, positive earnings trend, and adequate funding and liquidity. We believe the highly competitive and transactional nature of the business, along with the confidence-sensitive nature of institutional trading, partly offset these strengths.

The company is well positioned amid elevated interest rates, despite the persistence of volatile markets. Higher rates propelled net interest income in 2022 and the first quarter of 2023.

IBG's risk-adjusted capital (RAC) ratio of 36.3% as of Dec. 31, 2022, illustrates very strong capitalization. This remains the highest RAC ratio among the securities firms we rate--a key rating strength.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that IBG will continue to operate with a focus on the less confidence-sensitive retail segment while maintaining strong profitability. We also expect the firm will maintain its RAC ratio well above 25%, gross stable funding ratio (GSFR) in excess of 110%, and solid liquidity.

Downside scenario

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

- Profitability eroded substantially;
- The firm suffered material losses or an increase in risk;
- Its commitment to strong capitalization unexpectedly eroded; or
- Liquidity deteriorated.

Upside scenario

We see little upgrade potential over the outlook horizon, given the relatively high rating and the firm's smaller franchise than higher-rated peers.

Anchor: Reflects U.S. Securities Firms' Economic And Industry Risks

The 'bbb-' anchor, or starting point, for our ratings on securities firms in the U.S. reflects both risks shared with the banking sector and risks specific to the U.S. securities sector.

Our 'bbb+' U.S. bank anchor reflects our view of the U.S.'s diversified, high-income, and resilient economy. We see a stable trend on economic risk, given S&P Global Ratings economists' base case is for a shallow recession in 2023, although they also see rising risks to the downside. Our view of banking industry risk balances the regulatory enhancements made after the global financial crisis and deep capital markets against the elevated uncertainty and volatility that arose in March 2023 after some midsize bank failures. That uncertainty showed that challenges can still arise in the banking industry despite many positive changes since the global financial crisis (see "Outlooks On Four Large U.S. Banks Revised To Stable From Positive On Uncertain Operating Conditions; Ratings Affirmed," March 31, 2023).

The securities firm anchor is two notches below the bank anchor to reflect our view of the sector's incrementally higher industry risk relative to banks. Risks include the sector's lower, but still material, regulatory oversight and institutional framework; higher competitive risk; and typically less stable, more transactional revenue. Also, even accounting for the liquidity of domestic capital markets, differences in assets, and the U.S. investor insurance scheme (The Securities Investor Protection Corp.), funding risk for securities firms is higher than for banks, in our view, because securities firms typically lack central bank access.

Business Position: Growing Brokerage Business With Lower Recurring Revenue

We believe IBG has a solid market position as a global electronic broker to direct and indirect retail as well as small institutional clients. It allows clients to trade exchange-listed options, stocks, bonds, foreign exchange, futures, and mutual funds at more than 150 market centers worldwide. IBG is the leader in daily average revenue trades (DARTs) per account among the U.S. brokers that report DARTS and has grown client assets much more rapidly than peers. However, with $343.1 billion in total client equity as of March 31, 2023, IBG remains much smaller than some rated U.S. retail discount brokerage peers.

The firm's mix of business has shifted from market-making to brokerage, which now accounts for 99% of revenue. The company retains some options market-making in India and Hong Kong, as well as some offerings in specific products (such as some "delta one" products).

IBG offers brokerage clients a high-functionality platform. The firm has differentiated its platform to serve the specific needs of its customer segments beyond retail traders and investors, including introducing brokers, registered investment advisers, and institutional clients like hedge funds. The capabilities of the firm's trading platform, its tailored ability to meet the needs of a broad variety of client types, aggressive pricing, and geographic expansion continue to foster strong growth in the electronic brokerage business, with total accounts up 21% while customer equity, because of market conditions, was down 4% year over year as of end-March 2023.

The contribution of trading-related income (mostly commissions on customers' transactions), which we view as potentially less stable than contractually recurring fees and stable sources of net interest income, is higher at IBG than at most rated retail brokerage peers. The firm's main source of revenue other than trading is net interest income. In light of the most recent rate cycle, IBG's net interest income grew 126% year over year to $637 million in the first quarter of 2023. The company continues to benefit as rate hikes add incremental revenue (about $50 million for every 25-basis-point hike, from higher net interest income on some margin loans and brokerage cash balances below $10,000).

Unlike most peers, IBG largely passes through Federal Reserve hikes to most U.S customers (i.e., those maintaining cash balances of more than $10,000). As a result, the sensitivity of net interest income to a change in rates is lower than for peers, but total cash credit balances have been more stable than for peers (most of which have experienced double-digit percentage declines) since the beginning of 2022.

We believe retail customers, including direct retail customers and those served through registered investment advisers and introducing brokers, are more stable and less confidence-sensitive than institutional clients. IBG continues to grow these accounts, with direct and indirect retail customers accounting for 55% and 23% of commissions (and for 42% and 40% of customer equity). We expect introducing brokers to become a bigger percentage of customer equity and commissions this year as IBG onboards more clients in this segment.

Unlike its purely retail peers, IBG has a significant number of of hedge fund and proprietary trading clients, which account for 27% of IBG's commissions and 17% of client equity (up from 19% and 16% in 2021, respectively). We consider these clients more confidence-sensitive and higher risk given their use of portfolio margining. We would view negatively a material increase in IBG's proportion of institutional clients.

Given its unique customer mix and response, IBG has been much less affected by leading discount brokers' move to reduce retail commissions on U.S. equities and exchange-traded funds and the per-trade commission on listed options to zero. Unlike its competitors that have entirely switched to zero-commission offerings on cash equity and exchange-traded funds, IBG offers a traditional low- (but not zero-) commission pricing option (IBKR Pro) and a zero-commission option (IBKR Lite). For clients that choose the IBKR Pro offering, IBG clears and executes their transactions without selling order flow to wholesale trading firms. By contrast, IBKR Lite generates revenue from payment for order flow and from higher margin rates and lower deposit rates that, in part, offset the zero commission.

The company claims that clients of IBKR Pro benefit from better execution prices compared with peers' prices. Because most clients choose IBKR Pro, we think the company is potentially less exposed than peers to risks related to payment for order flows--an area that is under regulatory scrutiny.

With operations spread across 33 countries in Europe, Asia, and the Americas, IBG has good and growing geographic diversification. Foreign operations include a small amount of market-making in Hong Kong and India but mostly electronic brokerage, as well as support clearing and customer service across multiple product types, predominantly exchange traded or settled. Brokerage clients from outside North America accounted for about 51% of client equity and 49% of commission revenue in 2022, down from 54% and 55%, respectively, in 2021. A large proportion of IBG's international clients activity is in U.S.-listed stocks.

The 2019 promotion of longtime president Milan Galik to CEO addressed the issue of succession for founder and majority shareholder Thomas Peterffy, who continues as chairman of the board and remains closely involved in the business. We view favorably senior management's and ownership's commitment to very strong capitalization and limited risk appetite and their focus on lower-risk brokerage.

Capital And Earnings: Very Strong Risk-Adjusted Capital

We view IBG's capitalization as very strong, given an expected RAC ratio of more than 35%, management and ownership's commitment to maintaining conservative capital levels, and strong risk-adjusted earnings. As of Dec. 31, 2022, the RAC ratio was 36.3%, reflecting the firm's commitment to strong capitalization and limited payout. This is the strongest RAC ratio out of all the U.S. securities firms we rate.

Further, the firm has no additional risks not covered in RAC, given its minimal illiquid and Level 3 assets. We expect the firm to continue to grow equity through good retention of earnings, with very limited stock buybacks and an annual capital payout ratio remaining below 50%. Interactive Brokers Group Inc.'s status as a public company gives IBG some flexibility to raise additional capital if needed. At the same time, Peterffy's controlling ownership limits investor pressure to distribute capital. At the end of the first quarter of 2023, the firm had $12.2 billion of total equity.

IBG's extensive use of technology gives it a low expense base, which allows it to be a low-cost provider while still generating pretax margins typically above 60%. At the end of March 2023, the company generated a 72% pretax margin. The company's earnings are also strong on a risk-adjusted basis, with three-year average core earnings to S&P

Global Ratings risk-weighted assets of 5.59%, higher than peers' average.

All of IBG's regulated subsidiaries have considerable excess regulatory capital, totaling $8.7 billion as of Dec. 31, 2022.

Risk Position: Excess Capital Helps Offset Operational Risks

We believe the firm's good risk management, relatively modest risk appetite, and loss experience remain supportive of the rating, despite some periods with higher-than-peer losses on client margin loans.

In its brokerage business, IBG limits its credit risk and collateral-posting requirements by trading almost exclusively in listed or exchange-settled securities and cash foreign exchange. Counterparty risk with clearinghouses is limited given high credit ratings and mutualization of risk. Cash foreign exchange, metals, and contracts for difference transactions are done only with large, highly rated banks.

For margin lending, the firm employs real-time margin compliance monitoring technology, which allows it to quickly liquidate customers' positions if their equity falls below margin requirements. Based on the firm's assessment of client exposures, concentration or leverage, and market conditions, it also limits exposure or client risk through its pricing, imposing additional limitations or increasing margin requirements.

We view IBG's management of its margin loan book ($39.5 billion as of March 31, 2023) as adequate. For example, its total margin loan losses in 2021 were minuscule despite the high volatility in meme stocks that year. However, IBG has had some notable margin loan losses in the past. For example, it recognized an aggregate loss of approximately $42 million on margin loans in the first quarter of 2019, related to some customers' relatively large positions in a U.S.-listed company whose accounts fell into deficit when the stock price dropped precipitously. The rapid decline in price and lack of liquidity in the stock made it difficult to liquidate the stock to bring clients back into margin compliance. We believe this demonstrates the risks of margin lending, particularly with a global customer base. That said, the amount was very small relative to IBG's total capital, and the firm still posted solid net income in the quarter.

The firm also incurs some market risk from clients' trading options. For example, in a market crash scenario (with stock prices down or volatility up), clients selling put options might be unable to meet their financial commitments, putting IBG on the hook to counterparties (most likely clearinghouses) to absorb the losses. We believe such risk is well monitored through adequate margining, with the firm constantly revising its volatility stress assumptions based on market conditions. Nonetheless, clients' derivatives activity caused IBG to indemnify $104 million of clients' losses in April 2020 related to an IBG system issue that prevented clients from seeing or acting on negative prices in West Texas Intermediate energy futures.

Aside from clients' derivatives trading positions, trading risk is small, with only $383 million of securities on the balance sheet as of March 31, 2023.

Operational risk has fallen with the wind-down of most market-making operations, except in India and Hong Kong. Still, the use of proprietary models (i.e., algorithms) and trading systems to execute a large volume of trades in the residual market-making segment exposes the firm to operational risk because a malfunctioning algorithm could result in the accumulation of undesired directional positions and expose the company to principal losses. This being said, the strength of IBG's capitalization offsets the firm's exposure to low-probability, high-impact events, given it has a cushion of approximately $6.77 billion of total adjusted capital above our 15% RAC ratio threshold for very strong capitalization.

Unlike peers such as Charles Schwab that cash sweep a majority of brokerage cash to their own banks and invest in securities to grow net interest income (at the banks), IBG does not own a bank, and it deposits clients' cash to third-party banks (or invests into short-term U.S. Treasuries), therefore largely insulating itself from interest rate risk (and rising rates that may affect the value of the securities portfolio).

Funding And Liquidity: Highly Liquid Balance Sheet And Solid Funding

Our view of IBG's funding and liquidity incorporates its very liquid balance sheet, excess stable funding of its less liquid assets, and good liquidity management. IBG's GSFR--available stable funding to the illiquid portion of its assets--was solid at 198% as of Dec. 31, 2022.

While most of IBG's clients are more stable retail customers, we believe IBG's institutional customers (such as hedge funds) expose it to more customer confidence sensitivity than purely retail peers, given the firm's reliance on client balances to support client activity.

IBG's liquidity coverage metric (LCM)--balance-sheet liquidity sources relative to balance-sheet liquidity needs--was 1.00x as of Dec. 31, 2022. The LCM is artificially low because unlike at most other firms, IBG's securities borrowing and repo transactions are mostly not financing transactions. Further, we believe IBG's practices and accounting for customer securities lending activity understate the firm's liquidity in the LCM, given that collateral received on securities-borrowed transactions is segregated for clients.

IBG has a highly liquid balance sheet composed of cash; margin loans; exchange-listed marketable securities, which are marked to market daily; segregated customer assets; receivables from customers; and margins posted at central counterparties. Illiquid assets are less than 10% of total adjusted capital, and less than 1% of assets are Level 3.

The firm is exposed to margin and collateral calls on its open exchange-traded derivatives positions (on behalf of clients) as well as its securities loaned and open client positions. It maintains significant unencumbered liquidity to offset its exposure to margin and collateral calls, including approximately $100 billion of re-pledgeable collateral available from securities lending transactions and customer margin assets. For example, IBG is allowed to pledge to Options Clearing Corp. (the largest equity options clearinghouse in the U.S.) stocks owned by clients with open derivatives positions. IBG also has uncommitted secured broker bank lines, both to fund everyday needs and to provide ready access to the liquidity of its unencumbered securities.

IBG's brokerage business doesn't carry securities inventory, so its funding needs are limited primarily to customer margin loans ($39.5 billion as of March 31, 2023), which are largely funded by customer free credit balances. We view positively the firm's practice of calculating its regulatory reserves daily.

Additional Rating Factors

We base the 'a-' group credit profile on peer comparison. For example, IBG's capital position is stronger than that of Jefferies Financial Group, which has a group credit profile of 'bbb+'. Hence, we make a positive one-notch adjustment.

Our rating on Interactive Brokers LLC, IBG's U.S. broker-dealer subsidiary, is at the same level as the 'a-' group credit profile because it is an operating company. Our issuer credit rating on IBG is one notch lower than the group credit profile, reflecting the entity's structural subordination as a nonoperating holding company for regulated subsidiaries.

Key Statistics

Table 1

IBG LLC key metrics

	--Fiscal year ended Dec. 31 --				
(Mil. $)	**2022**	**2021**	**2020**	**2019**	**2018**
Adjusted assets	115,095	109,067	95,642	71,642	60,514
Adjusted common equity	11,567	10,176	8,966	7,906	7,123
Total adjusted capital	11,567	10,176	8,966	7,906	7,123
Operating revenues	3,067	2,714	2,218	1,937	1,900
Noninterest expenses	1,066	924	949	736	703
Net income	380	308	195	161	169
Core earnings	1,842	1,636	1,179	1,089	1,122

Table 2

IBG LLC business position

	--Fiscal year ended Dec. 31 --				
(Mil. $)	**2022**	**2021**	**2020**	**2019**	**2018**
Total revenues	3,067	2,714	2,218	1,937	1,900
Total revenue growth (year over year) (%)	13.01	22.36	14.51	1.95	18.09
Net interest income/operating revenues (%)	54.39	42.30	39.31	55.91	48.89
Fee income/operating revenues (%)	49.10	57.77	58.03	43.47	48.32
Pretax profit/operating revenues (%)	65.15	65.84	56.63	59.73	62.95
Core earnings/average adjusted common equity (%)	16.94	17.09	13.98	14.49	16.59

Table 3

IBG LLC capital

	--Fiscal year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Leverage ratio (U.S. GAAP)	10.05	9.33	9.37	11.04	11.77
Adjusted total equity/adjusted assets	10.05	9.33	9.37	11.04	11.77
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00

Table 4

IBG LLC earnings

	--Fiscal year ended Dec. 31 --				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Personnel expenses/operating revenues	14.80	14.70	14.65	14.87	13.89
Cost to income ratio	34.76	34.05	42.79	38.00	37.00
Core earnings/operating revenues	60.06	60.28	53.16	56.22	59.06
Internal capital generation/prior year's equity	3.34	3.01	2.06	1.83	2.19

Table 5

IBG LLC funding and liquidity

	--Fiscal year ended Dec. 31 --				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Gross stable funding ratio	198.44	137.01	164.35	181.82	192.58
Short-term wholesale funding/adjusted assets	7.91	10.97	10.56	9.12	7.15
Liquidity coverage metric (x)	1.00	0.65	0.70	1.04	1.06
Brokerage customer payables/adjusted assets	80.97	78.52	79.34	78.51	79.31

IBG LLC--rating component scores

Issuer Credit Rating	BBB+/Stable/--
SACP	a-
Anchor	bbb-
Business position	Adequate
Capital and earnings	Very strong
Risk position	Adequate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	+1
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	-1

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology , Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021

- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of May 31, 2023)*	
IBG LLC	
Issuer Credit Rating	BBB+/Stable/--
Issuer Credit Ratings History	
26-Apr-2022	BBB+/Stable/--
24-Nov-2020	BBB/Positive/--
04-May-2020	BBB/Stable/--
Sovereign Rating	
United States	AA+/Stable/A-1+
Related Entities	
Interactive Brokers LLC	
Issuer Credit Rating	A-/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.