Interactive Brokers Group (IBKR)
Q3 2015 Results – Earnings Call Transcript

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Executives

- Thomas Peterffy - Chairman and CEO
- Paul Brody - Group CFO

Analysts

- Rich Repetto - Sandler O'Neill
- Chris Allen - Evercore Partners
- Conor Fitzgerald - Goldman Sachs
- Chris Harris - Wells Fargo
- Rob Koehn - Ivy Lane Capital
- Robert Forster - Private Investor
- Mac Sykes - Gabelli
- Charif Takieddine – Compound Partnership
- Nicholas Davidoff - Davidoff Capital, LLC

Operator

Good day, ladies and gentlemen and welcome to the Interactive Brokers Group Third Quarter Financial Results Conference Call.

At this time, all participants are in a listen-only-mode. Later, we will conduct a question-and-answer-session and instructions will follow at that time. [Operator Instructions] And as a reminder, this conference call is being recorded.

I would now like to turn the conference over to Bill Cavagnaro, Investor Relations. Please begin.

Bill Cavagnaro - IR

Thank you, operator, and welcome, everyone. Hopefully by now, you've seen our third quarter earnings release, which was released today after the market closed and which is available on our website.

Our speakers today are Thomas Peterffy, our Chairman and CEO, and Paul Brody, our Group CFO. We'll start the call with prepared remarks about the quarter and then we'll take questions. Today's call may include forward-looking statements which represent the company's belief regarding future events and by their nature are not certain outside the company's control.

Our actual results and financial condition may differ, possibly materially from what is indicated in these statements. We ask that you refer to disclaimers in our press release and you should also review a description of risk factors and reports filed with the SEC.

I'd now like to turn the call over to Thomas Peterffy.

Thomas Peterffy - Chairman and CEO
Good evening and thank you for joining our third quarter earnings call. Our pre-tax comprehensive income for the quarter was $150 million. The dollar rose against the global by 1.5% over the quarter, diminishing our dollar denominated results by $76 million. Excluding these currency effects, our pretax earnings would have been $226 million for the quarter. I should also mention here that we have taken a reserve of $7 million for likely bad debts, without which we would have been at $233 million, not very far from the $250 million, which is where we previously said we were hoping to be by the end of 2016.

As you know, volatility has reawakened in the past quarter and that benefited both our brokerage and market making business in the forms of bigger customer volumes and wider spreads in the market.

In the brokerage segment, due to global market retreat, our margin loans were contracted by $3.2 billion from $19 billion at the beginning of the quarter to $15.8 billion at the end. Similarly, the total amount of customer equity decreased by $3.9 billion. On the other hand, our DARTs for the quarter were 683,000, which is a new all-time high and our accounts have expanded to 322,000.

The environment for the growth of our brokerage business remains excellent. The large banks are continuing to cut back on the business, raising prices and forcing prime brokerage and correspondent clearing customers to find new homes or pay up to new minimum requirements. They're raising the minimum equity a prime brokerage customer must maintain in the account and they are setting higher required minimum commissions that accounts must pay. These minimums vary not only among prime brokers, but even within the same prime broker. They are as low at $100,000 minimum commission and $10 million equity all the way to as high as $300,000 minimum commission and $50 million equity. This data comes to us from new potential customers we speak to and who are being asked to generate higher fees. These numbers understandably may reflect individual sales people's estimates of what they can get away with instead of hard and fast limits set by management of each specific prime brokers.

Similarly, correspondent clearers for introducing brokers are increasing charges and the field of our competitors continues to narrow. JPMorgan may have started an exodus from this business as they increase capital requirements on the part of large banks being in the clearing business and custody business is becoming ever more difficult to justify. Add to this the increased burden of regulatory and compliance requirements and having to cope with continuous technology updates and competition from broker dealers such as Interactive Brokers and JPMorgan's move may begin to make a lot of sense to other large correspondent clearing banks.

As I indicated to you in my last quarterly update, we are spending much more programming resources on compliance automation as the requirements vary as we move to different countries around the world. The way we see it, regulations will drive many of our competitors into the ground. There are more and more diverse laws and regulations and ever larger number of examiners and enforcers whose productivity and output in some cases seems to be measured by the amount of fines they collect. We view this as another opportunity for us to compete by building brokerage technology. We are building compliance systems that we need for the many different jurisdictions where we are active around the world, but we do this only once and we reuse those parts that overlap, while our competitors, who are much less automated, must hire more and more people and people tend to be more error-prone than automated systems. Having to pay for all these people and errors, they will ultimately have to raise prices even further.

Just this past week, we came out with our latest periodic communique that summarizes the many improvements we have made to our systems during the past several months. The most significant one of these is the way we deal with applications for new accounts that we expect will increase our number of account openings. Until now, only about 35% of new account applicants actually completed their applications and funded their accounts. With this new system, as soon as the applicant enters their username, password, and email address, we immediately send to them our trading platform with 15 minute delayed prices. They can populate the screens and set up optional fields the way they would want to use the actual account. They can see all of our trading tools and analytics and fundamental and technical research that we can offer for free. They can try how the platform works.

In another week or so, we will be releasing features for simulated trading on the platform for accounts in the application phase, so that applicants will be able to do paper trading and will be able to see and modify all of our dynamic reports, fee commission, and margin and financing charges and compare those to what they pay at their current brokers. All the advantages of coming to Interactive Brokers will be demonstrated with just one exception. Since the trades will be simulated, we'll not be able to demonstrate our better executions until they open and fund an actual account.

We believe that once traders experience our technology, they will want to become full clients and a much greater percentage of applicants will fund their accounts. Upon funding, the demo account, which they use to try things out, will become a fully functioning account preserving all the previously established settings.

People who were not contemplating opening a real brokerage accounts will be able to use this account indefinitely for free to follow the markets or to experiment with our various trading tools and facilities such as portfolio builder, probability lab, the options strategy lab or just for educational purposes for themselves or for younger family members.

Over the last several years, we have come to realize that just offering the best stuff to people is not enough. We still have to convince people to try it and see for themselves. This new instant demo system they can try for free. I would like to urge those of you who are interested in the details of the many other new developments we have recently made to the platform to visit our website and read our latest communique.

In market making the rising volatility should have resulted in a better outcome than we actually had. The fact is that a relatively large portion of the profits we earned in this quarter were made on August 24 on the day where many stocks and ETFs opened in a free fall. But in retrospect, we should have done much better on that day. Why didn't we? Because market makers like us and I assume many other market professionals were reluctant to step in and buy for fear of not knowing if our buys may be later canceled while the hedging sales for other products would remain valid as it has happened on other similar occasions in the past.

We strongly believe that the market would have been much more orderly had the exchange regulators followed our recommendations of one, not allowing trades to take place that can later be nullified and two, holding liquidity removing orders for some random period of time not to exceed, say, 10 or 20 milliseconds. Rules to this effect would have encouraged market makers and bottom fishers to enter the market at earlier points.

Now for the actual numbers and how they characterize the quarter, here is our CFO, Paul Brody.

Paul Brody - Group CFO

Thank you, Thomas and thanks, everyone, for joining the call. As we usually do, I'll review the summary results and then give some segment highlights before we take questions.

Third quarter results were driven by another strong core performance in brokerage and improved profitability in market making, offset somewhat by losses on currency movements. The late August market turbulence spurred high trading volume leading to additional revenues in both brokerage commissions and market making trading gains. Overall brokerage results were tempered by higher than usual customer bad debt expenses and a pullback in customer margin borrowing.

Our financial statements include the GAAP accounting presentation known as comprehensive income. Comprehensive income reports all currency translation gains and losses, including those that reflect changes in the US dollar value of the company's non-US subsidiaries, known as other comprehensive income or OCI, and these are reported in the statement of comprehensive income.

The US dollar strengthened relative to most of the other major currencies during the third quarter of 2015 and as a result, the currency basket in which we keep our equity, which we call the GLOBAL, weakened against the US dollar by 1.5%. OCI is a component of the total GLOBAL effect and the rest is contained in other income. We estimate the total negative effect from the GLOBAL on our reported earnings per share for the quarter to be $0.14 with $0.12 reported as OCI and $0.02 as other income.

Overall operating metrics for the latest quarter were higher across all product types versus the year ago quarter. Electronic brokerage metrics continue to show solid increases in the number of customer accounts and customer equity.

Total and cleared customer DARTs were each up 28% from the year ago quarter and up 11% and 10%, respectively from the second quarter of 2015. Orders from cleared customers who clear and carry their positions and cash with us and contribute more revenue accounted for 91% of total DARTs holding steady with recent quarters.

Market making trade volume was up 5% from the prior year quarter. Other metrics were positive as well, as volatility levels were up markedly and the actual to applied volatility ratio rose above 1 for the first time since 2011.

Net revenues were $359 million for the third quarter, up 110% from the year ago quarter, which contained large currency translation losses. Trading gains were $87 million for the quarter, up 107% from the year ago quarter.

Commissions and execution fees were at $167 million, up 26%. Net interest income was $106 million, up 8% from the third quarter of 2014 and brokerage produced $102 million and market making $2 million with the remainder in corporate.

Other income was a loss of $1 million, up from the loss of $102 million in the year ago quarter. This was driven primarily by smaller currency translation losses, which are reported in the corporate segment and largely offset by brokerage revenues from market data fees, exposure fees and order flow income from exchanges.

Non-interest expenses were $157 million, up 20% from the year ago quarter. Within the non-interest expense category, execution and clearing expenses totaled $63 million, up 21% from the year ago quarter, driven by higher volume in both segments. Compensation expenses were $56 million, a 14% increase from the year ago quarter.

At September 30, our total headcount was 1,052, an increase of 12% from the year ago quarter and 10% on the prior year end. Within the operating segments, we continue to add staff and brokerage and cut back in market making. About 17% of the year-over-year increase was due to the addition of staff on the purchase of Covestor, which closed during the second quarter.

Customer bad debt expenses were $7 million, up from $1.5 million in the year ago quarter, primarily reflecting reserves for losses taken by customers in the late August market turbulence.

As a percentage of the net revenues, total non-interest expenses fell to 44% from 77% in the year ago quarter. Out of this number, execution and clearing expense and compensation expense accounted for 18% and 16%, respectively. Our fixed expenses were 26% of net revenues.

Pre-tax income was $202 million, up 405% from the same quarter last year. For the quarter, brokerage accounted for 80% and market making at 20% of the combined pretax income.

For the third quarter, our overall pre-tax profit margin was 56% as compared to 23% in the third quarter of 2014. Brokerage pretax profit margin was 61%, down from 63% in the year ago quarter and market making was at 51%, up from 14% in the year ago quarter.

Comprehensive diluted earnings per share were $0.23 for the quarter, as compared to a loss of $0.13 for the third quarter of 2014. Excluding OCI, diluted earnings per share were $0.35 for the quarter, as compared to $0.05 for the same period in 2014.

To get a better understanding of the progression of our business, it may be helpful to isolate the core operating results. For the quarter, excluding the currency effects, our core results were as follows.

Net revenues were $383 million, up 32% from the year ago quarter. Pre-tax income was $225 million, up 41% from the same quarter last year. Overall pre-tax profit margin was 59%, up from 55% in the year ago quarter, and diluted earnings per share were $0.37 for the quarter, as compared to $0.24 on the same basis for the third quarter of 2014.

Turning to the balance sheet, as a result of the growth of our brokerage business and the withdrawal of capital from our market making operations, through regular and special dividends, brokerage now accounts for about 80% of our combined balance sheet assets from the two segments.

From the year ago quarter, cash and securities segregated for customers rose 37%, while secured margin lending to customers fell 8%. Positions and securities held by our market maker units grew by 7% as the markets presented us with greater trading opportunities.

According to our announced policy, regular quarterly dividends will continue to temper the capital employed in the market making segment. In the third quarter, our market making net earnings fell slightly short of the amount needed to fund the dividend.

Our balance sheet remains highly liquid with low leverage. We actively manage our excess liquidity and we maintain significant borrowing facilities through the securities lending markets and with banks. For the general practice, we hold an amount of cash on hand that provides us with a buffer should we need immediately available funds for any reason.

On September 30, we maintained over $3 billion in excess regulatory capital in our broker dealer companies around the world, of which about 66% is in the brokerage segment. We continue to carry no long-term debt and our consolidated equity capital September 30, 2015 was $5.28 billion; of which approximately $3.4 billion was held in brokerage, $1.8 billion in market making, and the remainder in the corporate segment.

Turning to the segments, beginning with electronic brokerage, customer trade volumes were up across all product types. Cleared customer contract and share volume was up 20% in options, 36% in futures, and 15% in stocks.

Foreign exchange volume also increased from the year ago quarter. Customer accounts grew by 18% over the total on September 30, 2014 and by 4% in the latest quarter. Total customer DARTs were

683,000, a new record level, up 28% from a year ago quarter and 11% from the second quarter of 2015. Our cleared customer DARTs were 620,000, also a record and up 28% on the year ago quarter and 10% from the prior quarter. The average number of DARTs per account on an annualized basis was 493, up 8% from the 2014 period and 5% sequentially.

Commission revenue rose on a product mix that featured larger average trade sizes in options and futures and smaller in stocks. This resulted in an overall average cleared commission per DART of $4.10 for the quarter, lower by 3% from the year ago quarter and 5% sequentially. Note that commissions include exchange fees which can vary widely.

Customer equity grew to $62 billion, up 13% from September 30, 2014, but down 6% sequentially outpacing the S&P 500 Index, which fell 3% over the past year and 7% over the last quarter. The source of the longer term growth continues to be the steady inflow of new accounts and customer assets, so the drop for the quarter reflects the August collapse in the markets.

After building steadily for a number of quarters, margin debits decreased 9% from the year ago quarter, as customers responded to the volatile markets by reducing their leverage.

Customer credit balances continue to grow progressively, increasing 18% over the year ago quarter though spread compression persists in restraining that interest income. Higher trade volumes resulted in top line revenue from commissions and execution fees with $168 million, an increase of 26% from the year ago quarter and 7% sequentially. These revenues are spread mainly across options, futures, stocks, and foreign exchange.

Net interest income rose to $102 million, up 11% from the third quarter of 2014 though down 4% sequentially. Low benchmark interest rates, which continue to compress the spreads earned by our brokerage unit, generally have been offset by steadily higher customer credit balances.

Our aggressive lending rates are attractive to margin customers though their appetite for margin borrowing is largely a function of market conditions. Our fully paid stock yield enhancement program continues to provide an additional source of interest revenue that is shared with our participating customers and we continue to improve our securities lending utilization to capture more revenue from lending hard to borrow stocks.

Net interest income as a percentage of net revenues was 34%, as our brokerage revenue are maintaining diversification between commissions and net interest income. With the growing customer asset base, we remain well positioned to benefit from a rise in interest rates.

Based on current balances, we estimate that a general rise in overnight interest rates of 25 basis points would produce an additional $45 million in net interest income annually. Further increases in rates would produce smaller gains because the interest we pay to our customers is pegged to benchmark rates plus a narrow spread.

Execution and clearing fees expenses increased to $45 million for the quarter, up 22% from the year ago quarter on higher trading volumes in all product classes and up 10% sequentially.

Fixed expenses were at $64 million, up 23% on the year ago quarter, primarily boosted by employee compensation. Pre-tax income from electronic brokerage was $184 million for the third quarter, up 19% on the year ago quarter and down 2% from the second quarter.

Now turning to market making, trade volume was up 5% from the prior year quarter, contract volumes were up 18% in options and 9% in futures, while stock share volume was up 42%.

Trading gains for market making for the third quarter of 2015 were $87 million, up 107% from the year ago quarter. Pre-tax income for market making was $46 million for the quarter, up 557% from the year ago quarter.

Execution and clearing fees expenses rose to $20 million for the quarter, up 33% on the year ago quarter, driven by higher trading volumes in all products. Fixed expenses were $24 million, down 11% from the year ago quarter spread across multiple expense categories. We continue our aggressive expense management as we monitor the performance of the market making business.

And in the corporate segment, the earnings reported for the corporate segment reflect the effects of our currency diversification strategy. Our overall equity, as measured in US dollars, is decreased by the strengthening of the US dollar against other major currencies.

More specifically, we estimate the overall loss from our strategy of carrying our equity in proportion to the basket of currencies we call the global to be about $76 million for the quarter.

Because $52 million of this loss is reported as other comprehensive income, this leaves a loss of $24 million to be included in reported earnings. This loss is the primary component of other income in the corporate segment.

Now, I'll turn the call over to the moderator and we will take some questions.

Question-and-Answer Session

Operator

[Operator Instructions] First question is from Rich Repetto of Sandler O'Neill. Your line is open.

Rich Repetto - Sandler O'Neill

Good evening, Thomas. Good evening, Paul. I guess the first -- good evening. The first question is on the trading, Thomas. You acknowledged that you sort of pulled back because of the, I guess the regulatory risk or the risk of trades being canceled.

And I guess the question is, in the next - what's going to alleviate that, because if you looked at the metrics of the - for the market maker, they were the best going back for at least eight quarters or so. And in this environment, we're still not meeting that cost of capital bar that you set?

Thomas Peterffy - Chairman and CEO

What is going to alleviate the pulling back, I said what would eliminate the pulling back, but I don't think it will happen for some reason I do not understand. Exchanges insist on keeping their options open to cancel some trades and not to cancel others.

So they clearly disable us from stepping into the market when it is very volatile. I would not think that our market making is going to become substantially better than it has been in the past. I don't see any reason why it would.

Rich Repetto - Sandler O'Neill

Understood. Okay. Getting to the broker, so the margin lending, and even when you looked at it quarter-to-quarter was up, the net interest income was up 8%. And I'm trying to understand. This is for Paul, where the balances, even ending balances were down 17% and even if we calculate the averages from your monthly they were still down 12%. I'm just trying to understand.

I know the customer payables probably help, but they didn't appear to be up that dramatically quarter to quarter. So the question is, just trying to understand this nice increase in the net interest income or net interest was flat quarter-to-quarter, just about flat?

Paul Brody - Group CFO

About flat quarter-to-quarter. What we're seeing is, despite the pullback in the debit financing, we've seen a significant increase in the credit balances steadily increasing.

And of course, while the spreads are still quite narrow versus what they might be invested in the marketplace, that's still on a larger and larger aggregate balance. So we're able to sort of keep up.

Rich Repetto - Sandler O'Neill
But I guess there are bigger balances year-over-year, but on quarter-to-quarter they were down whether you look at averages or period end. To me it appeared like a significant gap to make up from the customer payables to stay flat?

Thomas Peterffy - Chairman and CEO
Most of the margin borrowings came down towards the very end of the quarter, mainly after the August crash, so the end of August. So the first two months we had roughly the same margin borrowings as we had before.

Rich Repetto - Sandler O'Neill
Got it. Okay. That's helpful. And then last question, Thomas, is you talked about you've automated just about everything, if not everything, there. And there is new…

Thomas Peterffy - Chairman and CEO
Not yet. Slow down.

Rich Repetto - Sandler O'Neill
But you're getting there. I guess, the question would be, if only 35% were completed and funded and now you're bringing what you've done to the entire technology behind it.

Where could that, how can boost - what's your goal or target to boost that? Can it go to 45%, can it go to 50%, given that it's not more automated?

Thomas Peterffy - Chairman and CEO
We will not rest until we get there. We do not know what this specific - we will advertise this new and we very much go by word of mouth because it's...

Rich Repetto - Sandler O'Neill
Got it. Okay. You broke up a bit, but I think I got the answer and we'll just have to wait and see I think. That is all I have.

Thomas Peterffy - Chairman and CEO

Advertise this new feature and we hope that we will pick up some word of mouth because it's free for people to play with.

Rich Repetto - Sandler O'Neill
Yes. Got it. Thank you.

Operator
Thank you. And the next question is from Chris Allen of Evercore Partners. Your line is open.

Chris Allen - Evercore Partners
Good evening, Thomas. Good evening, Paul. Just following up on Rich's question around margin balance. It has been a big focus and I'm just curious, given the pullback.

I was wondering maybe if you could give us any color in terms of where they stand now? Have you seen stability since the end of the third quarter through the first couple of weeks of October?

Thomas Peterffy - Chairman and CEO
You are asking to tell you about the first couple of weeks of October as far as margin balances?

Chris Allen - Evercore Partners
Yes.

Thomas Peterffy - Chairman and CEO
I don’t know, I mean, am I allowed to talk about?

Paul Brody – Group CFO
Chris, it's generally our practice not to talk about the current quarter while we're on the quarterly call until after that quarter's over. It's just the practice.

Chris Allen - Evercore Partners
Yes, I know. Last quarter you told us it was down $2 billion at the end of the quarter. So I figured I'd just get an update just because it's such a focus, but fair enough.

I guess, just on the $7 million in bad debt expense, it sounds like you're just adding to provision. Was that actually - did you see customer losses, or is this just adding to reserve on expectations of potential losses?

Thomas Peterffy - Chairman and CEO

No, they are actual customer losses that may not be collectable.

Chris Allen - Evercore Partners
Got it. Okay. And then I think Rich covered everything with brokerage. I'm actually good right now. Thanks.

Thomas Peterffy - Chairman and CEO
Thank you.

Operator
Thank you. And the next question is from Conor Fitzgerald of Goldman Sachs. Your line is open.

Conor Fitzgerald - Goldman Sachs
Good evening.

Thomas Peterffy - Chairman and CEO
Good evening.

Conor Fitzgerald - Goldman Sachs
Just on the average commission rate, I understand the bulk of the downward pressure was because of higher volume and order size, but was there any impact from FX here? Just trying to understand if any of that's sustainable if the dollar remains strong?

Thomas Peterffy - Chairman and CEO
I don't - no, I think that would have a relatively small impact. That would not be a sizable thing to notice.

Conor Fitzgerald - Goldman Sachs
Okay. Then for the customers you've been signing up for prime brokerage, can you give us a sense of just what percent of these are coming versus are former clients of European banks versus US?

Just asking because there's been, obviously, a lot of news from some of the larger European banks speeding up some of their restructuring?

Thomas Peterffy - Chairman and CEO
Yes. So we have a number of smaller banks who used to custody with larger banks who are now looking at us and unfortunately, this is a long process. It takes them some time, as long as a year, to actually move their account over, but we have a few in the oven.

Conor Fitzgerald - Goldman Sachs

That's helpful. Then just on the other income line, not a huge line item, but the risk exposure fees, I think it's a relatively new revenue source for you. Can you just talk about what's driving the growth and if you think there's additional room to grow off of? I don't think you've disclosed it this quarter, but $7 million last quarter?

Thomas Peterffy - Chairman and CEO

So the risk exposure fee is there to pay for uncollectible bad debt. That's what it's all about. So we put through accounts on certain filters where we believe that it is quite possible, since we have to compete with other brokers who charge only exchange margins.

And we don't want to charge much, much more than exchange margins. We figured that every now and then we will have a loss. And so there is risk exposure fee is there for clients to see what it is. We have a facility for them to ask what-if questions, what if I did this trade or that trade, would my risk exposure fee go away or would it increase.

And so our primary intention with the risk exposure fee is to bring down the risk that certain client accounts are carrying. But if they are unwilling to, then we'll just charge them the fee and in the long run, we expect that fee will offset uncollectable losses.

Conor Fitzgerald - Goldman Sachs

Okay. That's very helpful. That's it for me, thanks.

Thomas Peterffy - Chairman and CEO

Thank you.

Operator

Thank you. The next question is from Chris Harris of Wells Fargo. Your line is open.

Chris Harris - Wells Fargo

Thanks, guys. A few questions on accounts. I'm trying to understand this new policy that you've created here.

And it sounds like as soon as soon as a login is created, the account is activated, but potentially not funded. Is that account going to show up on IBKR's total account profile?

Thomas Peterffy - Chairman and CEO

No. We report funded accounts.

Chris Harris - Wells Fargo

You report funded accounts, okay. As far as those funded accounts are concerned, when does an account actually become closed at Interactive? Is it when the account is no longer funded, or is it when the customer actually physically has to write to you?

Thomas Peterffy - Chairman and CEO

A customer can close his account himself, if an account balance goes under, I think its $100, we charge them a minimum $20 a month of inactivity fee. So if a person chooses to keep his account open, we… I'm not sure about these numbers, but the fact is, that eventually we ask the customer to please, can we send him his money or would he like to fund his account with more money and then we close the account. So we will not keep accounts open that are not funded.

Chris Harris - Wells Fargo

I see. Okay. In previous periods, you had been reporting really dramatic account growth in Asia.

And I'm just wondering if we can get any sort of an update whether there's been any change in the growth rate there given some of the volatility we've seen in the marketplace.

Thomas Peterffy - Chairman and CEO

I would guesstimate that the growth in Asia has slightly increased in the last month or two.

Chris Harris - Wells Fargo

Interesting, okay. With respect to your institutional business, Thomas, it sounds like you're quite bullish on that opportunity. Really just wondering, qualitatively, as you speak to your customers and potential customers there. How far along do you think we are in the migration from the banks? Do you feel like it's something that potentially could just be getting started?

Thomas Peterffy - Chairman and CEO

I think we're at the very beginning.

Chris Harris - Wells Fargo

Very beginning.

Thomas Peterffy - Chairman and CEO

Yes.

Chris Harris - Wells Fargo

Okay. All right. And then the last question. I know there's been some questions already about the net interest income. I'm wondering if you could clarify for us what you actually earn on margin balances versus what you actually earn on credit balances? I think that might help the audience in trying to figure out what's going on?

Thomas Peterffy - Chairman and CEO

It is roughly the same.

Chris Harris - Wells Fargo

Roughly the same. Okay. All right, thank you very much for answering the questions…

Thomas Peterffy - Chairman and CEO

I'm sorry, I mean credit balances are - margin balances are higher. So I mean, credit balances we earn roughly 60% as much as a margin balance.

Chris Harris - Wells Fargo

Okay. Thank you.

Operator

Thank you. The next question is from Rob Koehn of Ivy Lane Capital. Your line is open.

Rob Koehn - Ivy Lane Capital

Thomas, thanks for taking my question. Great quarter. Last quarter, you talked about the technology of competing brokers and how poor the technology was. What do you think in August when there are these widespread reports of Ameritrade, Schwab, Scottrade, and other brokers across the street having problems where customers can't login, they can't trade, they are unable to be active in the periods when the markets are most volatile?

What did that tell you and what does that tell you regarding the introducing broker opportunity?

Thomas Peterffy - Chairman and CEO

They had a very different type of client. While their clients trade roughly 11 times a year, our clients trade about 500 times a year. Obviously, when the markets become extremely volatile, we just have to multiply that by some number and they very quickly come up against the wall.

And in our case, we didn't have any such problems and I was told that we still have plenty of room to have even more trades. So, but…

Rob Koehn - Ivy Lane Capital
What causes their problems?

Thomas Peterffy - Chairman and CEO
Not enough bandwidth.

Rob Koehn - Ivy Lane Capital
There's not enough bandwidth.

Thomas Peterffy - Chairman and CEO
Right.

Rob Koehn - Ivy Lane Capital
Okay. And then on the introducing broker front, is there anything more that you can update over the last quarter, progress there?

Thomas Peterffy - Chairman and CEO
Well, we're actively pursuing introducing brokers and we every now and then we find one and we expect that business to grow. When we find larger ones such as Scottrade there are a couple not as large, but substantial that we currently are in discussions with.

And so as I expect that when it becomes very well known that we are in the business that other introducing potential introducing brokers will look at us and some folks that are currently self-clearing will give some thought to the idea of doing away with their own clearing systems and come to us because I think that net that would make them money.

Rob Koehn - Ivy Lane Capital
Right, and how many total introducing relationships do you have right now, estimate?

Thomas Peterffy - Chairman and CEO
I'm sorry I don't know the number.

Rob Koehn - Ivy Lane Capital
I mean, just generally speaking is it, I thought I read it was over 100?

Thomas Peterffy - Chairman and CEO

I'm sure it's over 100, yes, but some are small. There are some who have - the largest introducing broker has something like 9,000 accounts and the smallest one has maybe three.

Rob Koehn - Ivy Lane Capital

Right, okay. Okay. And then you sent out a shareholders questionnaire during the quarter, have you received any interesting feedback from that?

Thomas Peterffy - Chairman and CEO

I have received many interesting feedbacks and the basically the - what I have learned is that many people don't know what we have. I have always known that. But many people who are customers don't know what the platform can do.

So the more complex the platform becomes, the more difficult it is. So we hope that to some extent this demo account capability will alleviate that.

Rob Koehn - Ivy Lane Capital

Okay. And how do you plan to market the demo account? Is there a new advertising campaign coming?

Thomas Peterffy - Chairman and CEO

Yes.

Rob Koehn - Ivy Lane Capital

Okay. Great. Thanks. That's it for me.

Thomas Peterffy - Chairman and CEO

Thank you.

Operator

Thank you. And the next question is from Robert Forster, a Private Investor. Your line is open.

Robert Forster - Private Investor

Hi. Great quarter. I noticed that this past Friday, margin requirements for a lot of accounts were increased by 10% across the board without any notice and this left some leveraged hedge fund clients and individual investors scrambling to figure out what happened and why they couldn't trade.

First question is, what motivated the sudden change and what factors are you going to be looking at to consider for future changes in your margin requirements?

Second question is what changes are you thinking about for your internal process so that current and potential customers can have confidence they'll be notified of future margin changes in a timely fashion so they can manage their risk and capital accordingly?

Thomas Peterffy - Chairman and CEO
I'm extremely surprised that would have happened without notice. I think you probably have received an email that you overlooked.

Robert Forster - Private Investor
I mean I didn't and I know a hedge fund that I know people that also didn't receive that. The front line customer service people in Chicago were not initially sure what was going on either. So it sounded like it was not well-communicated internally?

Thomas Peterffy - Chairman and CEO
That's a very bad thing. I don't know. I apologize for that. That should not have happened. I'm surprised to hear that. At any rate, we are in a very complex area here.

I assume that you are referring to margin requirements on option positions, is that correct?

Robert Forster - Private Investor
This was for portfolio margin accounts, but certainly for equity accounts...

Thomas Peterffy - Chairman and CEO
Options in the account right?

Robert Forster - Private Investor
No, not necessarily. Just long and short equity accounts were also affected. As far as I could tell, the maintenance requirement for almost all equities from penny stocks to SPY were increased by 1.1x from what they were a couple of days ago.

I wasn't sure if this was your take on the markets becoming more risky, or trying to derisk at a global level, or if you were trying to address some of these bad debt issues or what it was?

Thomas Peterffy - Chairman and CEO

They all have to do with derivatives. It's not -- I'm not aware of any margin increases for straight equity positions.

Robert Forster - Private Investor
Okay.

Thomas Peterffy - Chairman and CEO
I'm sorry. I will look into it and let you know.

Robert Forster - Private Investor
Okay. Thank you very much.

Thomas Peterffy - Chairman and CEO
Thank you.

Operator
Thank you. The next question is from Mac Sykes of Gabelli. Your line is open.

Mac Sykes - Gabelli
Hi. Good afternoon, thanks for taking my questions. On the prime brokerage opportunity, would it ever make sense to just partner with one of these institutions that are shedding their smaller clients in exchange for maybe a referral fee or something so there are more clean client propositions?

Thomas Peterffy - Chairman and CEO
I don't think they want to stick their neck out. We have tried. We have tried and in a few cases, when we have tried, it didn't work. They make a recommendation then they remain liable for whatever happens from there on.

Mac Sykes - Gabelli
Okay. I'm not sure if you're aware, but Eaton Vance has been working on a new kind of exchange traded fund, the ETMF. They hope to launch it in the first quarter. I was just curious if you had dedicated any product development resources towards that product line?

Thomas Peterffy - Chairman and CEO
I don't even understand the opportunity.

Mac Sykes - Gabelli
Its exchange traded managed funds, ETMF. They're aimed at RIAs. NASDAQ has been working on it?

Thomas Peterffy - Chairman and CEO

Yes. And…

Mac Sykes - Gabelli

Just curious if you had worked on being able to offer those products to your clients next year?

Thomas Peterffy - Chairman and CEO

It would trade just like a stock, like any other ETF, no.

Mac Sykes - Gabelli

It would settle at the end of the day.

Thomas Peterffy - Chairman and CEO

Yes, it's just like. Yes. I think all we need to do is to list it, and it will work like anything else.

Mac Sykes - Gabelli

Okay. And then my last question is, on the stock, the amount of stock trading seems to have come down sequentially during the quarter. I think you had talked about perhaps low priced Asian stocks previously. Is there any more color on why that trend is occurring?

Thomas Peterffy - Chairman and CEO

I do not know why that came down.

Mac Sykes - Gabelli

Thank you very much. Nice quarter.

Operator

Thank you. The next question is from Charif Takieddine of Compound Partnership. Your line is open.

Charif Takieddine – Compound Partnership

Yes. Hi, Thomas. This is Charif, actually. The question I have is regarding, that you have always been a visionary when it comes to pricing and…

Thomas Peterffy - Chairman and CEO

We can't hear you.

Charif Takieddine – Compound Partnership

Yes. Can you hear me now?

Thomas Peterffy - Chairman and CEO
Yes.

Charif Takieddine – Compound Partnership
Okay. Great. I have a question regarding, there are some emerging companies such as Robin Hood that are offering trading for especially equity trading for zero dollars commission.
I was just wondering what was your take on commissions going forward five years down the line or even 7 to 10 years down the line, whether we'd see more pressure on the commissions, especially the equity commissions and what's your point of view on that?

Thomas Peterffy - Chairman and CEO
We are so much lower than all the major brokers that I do not believe that we will have any pressure. I do not believe that the Robin Hood model is maintainable once the customers look at the executions because Robin Hood is hoping to make the money on the executions. So I do not consider it a serious competitor.

Charif Takieddine – Compound Partnership
Do you expect to see commissions on equity going to zero anytime soon?
Thomas Peterffy - Chairman and CEO
No I do not. Not for people that care about the quality of execution. I don't think that our clients would ever go to Robin Hood, because they would immediately understand that it's not a good deal for them.

Charif Takieddine – Compound Partnership
Would you care to expand on that? On why it's not a good deal for them?

Thomas Peterffy - Chairman and CEO
Because Robin Hood makes the money on providing substandard executions. Okay. With any business you have to have income in order to service your customers, right. You make that income some way.

You either un-bundle like we do, where we say this is the commission and this is the interest rate and this is so-and-so, or you just send us the money and send us your order and we will let you know how you do, right. That’s what Robin Hood does. They don’t charge any commission but they must make the money somewhere. They must pay for the offices, the people, the computer systems etc. Right? How do you think they do that?

Charif Takieddine – Compound Partnership
I don't know. Okay. Fair enough. Thank you.

Operator
Thank you. The next question is from Nicholas Davidoff of Davidoff Capital, LLC. Your line is open.

Nicholas Davidoff - Davidoff Capital, LLC
Hello. Congratulations on a great quarter. Just a quick question for me. Can you speak to clearing, specifically, given that JPMorgan exited the business recently and Pershing is the last firm standing?

What are the barriers to entry in terms of you getting into liquid emerging markets like Turkey, Brazil, South Africa, can you speak to that quickly?

Thomas Peterffy - Chairman and CEO
Well, the issue is that if we ever went into one of these places like Turkey, there is, we do not see that we would be able to generate sufficient commissions to pay for the cost of going in there because there is not enough volume there.
But I do not quite see how that is connected with your idea of entering into the custody business.

Nicholas Davidoff - Davidoff Capital, LLC
Well, I mean, my thinking is that if you guys are going to enter a new market, you're probably going to be custodying there. It just seems likely. So I would just wondering, I guess, what you're seeing as a barrier to entry in terms of that holistic approach.

As a for instance, you do some more interesting currencies like the Russian ruble and my thinking was that there could be barriers to entry based on something like the currency versus some other esoteric regulation.

Thomas Peterffy - Chairman and CEO
I see what you're saying. So it's not the esoteric regulations. It is that we look at the cost and then we look at not only the cost of going in there but the cost of maintaining the operation and look at the potential revenue of how many executions we would do in that country and it doesn't balance.

Nicholas Davidoff - Davidoff Capital, LLC
Understood. I think just a comment for me, specifically, South Africa is a very liquid market. It's practically a developed market. So Redi Plus, for instance, is trading there and some other platforms.

From an electronic perspective, certainly, there seems to be a lot of commissions flowing through that market in particular and I would imagine some of the other mainstream emerging markets that really aren't even emerging anymore like Korea and Taiwan might fit that category.

Thomas Peterffy - Chairman and CEO
Korea is a currency issue. South Africa, you are correct, and we have been looking at the possibility.

Nicholas Davidoff - Davidoff Capital, LLC
Great. I look forward to hearing more about it.

Thomas Peterffy - Chairman and CEO
Thank you.

Operator
Thank you. And the last question is from Rob Koehn of Ivy Lane Capital. Your line is open.

Rob Koehn - Ivy Lane Capital
Just a follow up for me, Thomas. As I think about the business, I think about three major growth areas. You have the hedge fund business, the prime brokerage business number one, registered investment advisors number two, and introducing brokers number three.

How do you think about the relative scale of those three opportunities? How would you rank them in terms of what's most exciting to you over the next couple of years here of growth, prime brokers, registered investment advisors, introducing brokers? How do you think about those from a scale perspective?

Thomas Peterffy - Chairman and CEO
So the, we derive our largest income from sophisticated individual traders and that is the most lucrative for us. Secondly, the financial advisors and thirdly, introducing brokers. The issue with the introducing brokers and the financial advisor is that they are more likely to have the Schwab kind of a customer.

The kind of customer that very rarely trades and as a result, it is not so lucrative for us. So we like the folks, the individual traders, or people who trade in a group, or, obviously, hedge funds.

Rob Koehn - Ivy Lane Capital
So the prime brokerage opportunity would probably be the number one in terms of a large revenue opportunity?

Thomas Peterffy - Chairman and CEO

That's right. Yes.

Rob Koehn - Ivy Lane Capital

Okay. And how is the Scottrade introducing broker relationship starting so far? Is that doing well?

Thomas Peterffy - Chairman and CEO

That is going well. We are told that they are going to put more and more customers in our way and that they will begin to advertise our facilities, hopefully.

Rob Koehn - Ivy Lane Capital

Interesting. Okay. Great. That's great news. Thanks a lot.

Thomas Peterffy - Chairman and CEO

Thank you.

Operator

Thank you. There are no further questions in queue at this time. I'll turn the call back over for closing remarks.

Bill Cavagnaro - IR

Thank you, everyone, for participating today. As a reminder, this call will be available for replay on our website. We will also be posting a clean version of our transcript on the website tomorrow. Thanks again for your time.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. You may now disconnect. Good day.