Interactive Brokers Group (IBKR)
Q4 2015 Results – Earnings Call Transcript

January 19, 2016 04:30 PM ET

Executives

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

Analysts

- Chris Harris - Wells Fargo
- Rich Repetto - Sandler O'Neill
- Chris Allen - Evercore Partners
- Rob Koehn - Ivy Lane Capital
- Mac Sykes - Gabelli
- Conor Fitzgerald - Goldman Sachs

Operator

Good day, ladies and gentlemen and welcome to the Interactive Brokers Group Incorporated 2015 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. I would now like to introduce your host for today's conference Mr. Bill Cavagnaro, Investor Relations. Sir, you may begin.

Bill Cavagnaro - IR

Thank you operator and welcome everyone. Hopefully by now, you've seen our 2015 earnings release, which was released today after the market close and which is also 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 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 and outside the company's control.

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

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

Thomas Peterffy - Chairman and CEO

Good afternoon, everybody. Thank you for joining us on our fourth quarter 2015 earnings call. Our reported earnings this quarter were unfavorably impacted by the continuing increase in the US dollar against the basket of currencies in which we keep our capital and we call the GLOBAL.

In the course of the quarter, the US dollar increased by 0.9% against the GLOBAL, resulting in a reported loss of $49 million.

Further, in this quarter, we booked unfavorable marks in our treasury portfolio. Unlike most of our peers, we do not own nor are we owned by a bank, and as a broker, we must mark our treasury portfolio to market, while they do not. This quarter, the negative marks amounted to $52 million. For the entire year, the marks were negative $33 million. Our treasury portfolio is $16 billion and its duration is about one year, the longest instrument being just less than two years.

The yields on the two year averaged 1.06% on the last day of the year. It reversed from there to 87 basis points as of today. The safest way to secure our customers' cash is to hold treasuries. It is also our understanding that according to the new banking regulation, these type of financial deposits, this year, will have to be secured by treasuries even at the banks which may result in a squeeze on treasuries.

Indeed, we see treasuries maturing within three months currently being traded well under the Fed Fund rates. In our earnings statement we list the coupon payments we receive on our treasury portfolio and the amortization of the premium or discount to face value as part of interest income, and the gains or losses resulting from marking the portfolio to market as other income. Since we hold this portfolio in the Brokerage segment, it is part of the – these marks are part of our brokerage earnings.

All in all, for the quarter, our pre-tax income was $127 million and adjusting for the GLOBAL impact and the treasury marks, it would have been $198 million.

As to further details about our operating results, those of you who follow our monthly release of our brokerage metrics are familiar with these numbers and Paul Brody will also go over that, so I will not repeat them here at this time.

Instead of that, I would like to briefly touch on the significant events of the past year. In January, in an unprecedented action, the Swiss National Bank, decoupled the Swiss Franc from the Euro just a few days after they reaffirmed the peg. In the following few seconds, the currency moved up by about 20% on practically no trading volume. Several of our customers were short the Swiss Franc against the Euro and they suffered very large losses in excess of the liquidating value of their account. Net of our hedging activities and collection efforts, this amounts to approximately $117 million.

In the first quarter, we introduced the Interactive Brokers Investors Marketplace. We created the Marketplace to connect our hedge fund and advisor clients who want to attract additional capital to manage and our individual clients who are looking for managers to invest their money. The Investor Marketplace now has over 429 service providers, over 330 technology partners and 86 research providers. As we continue to build out the Marketplace, our customers will be able to satisfy all of their investment and financial services needs on our platform.

In March, Scottrade announced that they will use Interactive Brokers to execute and clear for some of their active traders, while they will retain the servicing of these clients' accounts. This was a very significant development for us, because it is the first nationally well-known broker who decided to use our technology. Our goal is to be the industry utility providing an exceptional product to brokers at a very low cost, cheaper and better than they could it themselves. This integration has gone smoothly. The clients are having a positive experience and this service is about to be expanded further.

We want to make it very clear that we do not compete for these clients. Our offering to our end clients are very different. We cater to financially and technologically sophisticated investors who have a clear understanding of market microstructure and do their own homework and do not require any advice or handholding from us.

Our volume tiered pricing where all the brokers' accounts are aggregated is geared to this kind of symbiotic relationship where we do the execution, clearing, custody and account management, while our introducing broker partners do all the client contact. So that brokers pay us a small fraction of what the individual account holder would pay for the same trade if he came to us directly.

This way the client receives all the technological advantages we have to offer, along with their reassuring high touch from the broker.

In March, Barron's named Interactive Brokers the best online broker for the 4th year in a row and we continue to rank as the lowest cost broker for the 11^{th} consecutive year.

In the second quarter, we launched the RIA Compliance Center to help advisors who are not yet on our platform to become independent and setup their businesses with us. This free online service allows advisors to find solutions to key compliance issues that are part of becoming an independent Registered Investment Advisor.

As the Compliance Center continues to be developed it is becoming an ever more valuable resource to many of our RIA clients. In addition, we built a free customer relationship management, CRM, system into our account management platform. This feature allows advisors to manage their clients' interactions and clients' account configurations without leaving the platform. While the Compliance Center for the time being is clearly oriented towards US regulations, and European and Asian versions are still in the distant future, the CRM is clearly applicable to helping our non-US managers.

In the third quarter, we saw the first wave of the fear of the Chinese slowdown hitting the markets and our clients. In its wake, our clients' equity and margin balances dropped precipitously. Interestingly, opening and funding of new accounts continued at the same pace, although that did slow in December. We think that the December slowdown is a recurring annual event that has to do with the holidays and is usually made up for early in the following year.

In the fourth quarter, we introduced Portfolio Builder. The Portfolio Builder allows our clients to screen stocks based on fundamental data and research rankings. We have 86 research providers on the platform, 13 of whom provide stock rankings and the Portfolio Builder allows for the assignment of different weights to each fundamental data point and research ranking and to assemble a portfolio based on this.

The portfolio may contain long and short positions in any desired proportion and be periodically, automatically rebalanced at pre-determined time periods. To put the icing on the cake, the user may back-test the portfolio's performance, rebalancing it based upon contemporaneous historical data available at the time. When someone is happy with the portfolio they built, they can allocate a portion of their capital to it and, with a click of the mouse, acquire the portfolio and keep it automatically managed according to the predetermined criteria until they change it.

This is the ultimately flexible robo advisor that any of our clients can create for themselves completely free of charge and completely free of any management fee.

What we hope is even more enticing; the Portfolio Builder is available to our demo users. As we advertise on television, anyone can, upon giving us their email address and picking a user name and a password, download our trading system, and open a free paper trading account. Those prices, which we are charged for by the exchanges, are delayed by 15 minutes but others such as forex are real-time. People can try the system doing simulated trades with simulated money and use all of our analytics, research, trading and risk management tools, option overlay, probability, volatility and strategy labs and even the Portfolio Builder absolutely free.

Why are we doing this?

We want to be completely transparent. Simulated commissions, margins and financing charges are identical to what real customers pay on real accounts. We want people to be able to explore the system without any commitment and of course, we hope that they will eventually complete an account application and fund a real account, but they do not have to. People can use a simulated account, learn to follow the markets on our platform, indefinitely. We hope that they will tell their friends and neighbors about it.

As these highlights of the past year indicate, we are committed to our strategy to build the best and still the least expensive brokerage platform in the world for financially and technologically sophisticated investors and institutions. We are very optimistic about the prospect of the business and gratified by the accelerating growth of our hedge fund and proprietary trading group customers on the one hand and our introducing broker customers on the other.

This is to some extent driven by increased capital requirements on the big banks and increasing regulatory requirements on brokers. Compliance costs are rising very rapidly for us too. But we decided to look at this as an opportunity to build an additional competitive edge by automating every aspect of our compliance systems.

I'm often asked to estimate – I'm often asked for an estimate of our share of our addressable customer base we currently have and how much further can we grow. I used to say that we had about 5%. I now need to revise this figure.

The only category of customer where we are anywhere near exhausting the market is the proprietary trading groups, where we may have as much as a 25% market share, with $10 billion of account equity and these accounts are distributed in the US, Europe and Asia fairly evenly.

Among financially sophisticated individual traders with $25 billion of equity, we may have as much as 15% of the current market, although if you live in New York City, you will get the impression that this number is much higher. This is a very rapidly growing market segment globally and we expect that we will eventually approach 100% share in this group, just like with proprietary traders.

Among hedge funds, our estimated share with $5.5 billion deposits is only 0.2%. Most of our clients of this stage are the smaller funds and the more execution and cost sensitive funds who often use us for execution only and give up their trades to the large banks for custody.

We expect that we have a very large potential to grow here as funds become more execution sensitive and cost sensitive, and our name recognition and acceptance by the investor class grows. We also think that as our equity increases and too big to fail becomes questionable, we will become recognized as a potentially safer prime broker than the big banks with their huge OTC derivative books.

Investment advisors have $18 billion with us, while we estimate their total AUM well over $20 trillion. So, that even on a very conservative basis, we have no more than 0.1% of this market.

Finally, there is a huge global business of brokers all over the world, large and small. Many of them are just starting their new businesses and many others who have been in the business for many decades and cannot keep up with the technological and regulatory requirements.

All these potential partners realize that even if they could build the technology that they would ideally use to be able to compete in this business, it would take them a very long time and cost them a huge amount of capital. Setting up the infrastructure of exchange and clearing memberships and connections with the thousands of different local bank accounts, the subsidiaries all over the world would be an enormous undertaking. It is much less expensive to come on to our turnkey system.

There is no reason why new entrepreneurs would not try to start a business today on our platform with the aim of competing with the largest established online brokers on this and other continents.

With $9 billion, we have just a tiny fraction of this market today. Putting this altogether, while we do have considerable market share among individuals and prop traders it seems that we have so far penetrated less than 1% of our total addressable market and accordingly, we could easily grow a hundredfold and still have room left over.

With that, I would like to turn the floor over to Paul Brody who will bring us back to solid ground to the world of actual numbers.

Paul Brody - Group CFO

Thank you, Thomas. Thanks, everyone, for joining the call. As usual, I'll first review our summary results and then will give segment highlights before we take questions.

The fourth quarter operating results came down from the third quarter's strong showing which was driven by high trading volume and volatility during the August market turbulence. Despite the pullback from certain customers after this period, brokerage operating results remain strong and market making outperformed the relatively weak performance of the year-ago quarter. However, currency translation and mark to market losses on non-trading investments were significant factors in the latest quarter's performance.

As compared to the year-ago quarter, net revenues this quarter were driven by increases in net interest income, smaller currency translation losses and higher trading gains, offset by declines in brokerage commissions and temporary mark to market losses on investments in US government securities that Thomas mentioned.

Full-year results showed strength in core brokerage and market making activities. Our net pre-tax profits at $458 million represented a return on average equity of 9% and a profit margin of 39%. Excluding the currency translation effects and the unusual losses taken on the Swiss franc event in January 2015, our core profit margin was 57%, in line with the prior year.

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 the changes in the US dollar of the company's non-US subsidiaries, known as other comprehensive income or OCI, and these are reported in the statement of comprehensive income. US dollar strengthened relative to all other major currencies during 2015.

As a result, the currency basket in which we keep our equity which we call the GLOBAL weakened against the US dollar by an unusually large amount. In aggregate, the GLOBAL as expressed in US dollar terms declined about 0.9% for the fourth quarter and 5% for the year. OCI is a component of the total GLOBAL effect and the rest is contained in other income.

We estimate that total negative effect from the GLOBAL on our reported earnings per share to be $0.10 for the quarter and $0.51 for the full year. Overall operating metrics for the latest quarter were mixed across major product types versus the year-ago quarter. Average overall daily trade volume was 1.31 million trades per day, up 5% from the fourth quarter of 2014. However, contract and share volumes in brokerage were somewhat lower, pointing to smaller average order sizes. Electronic Brokerage metrics showed solid increases in the number of customer accounts and customer equity.

Total and cleared customer DARTs were both up from the year-ago quarter. Orders from cleared customers who clear and carry their positions in cash with us and contribute more revenue held steady at 91% of total DARTs. Market making trade volume was up 5% from the prior-year quarter, though contract and share volumes were mixed across product types. Other metrics such as higher VIX but lower actual to implied volatility ratio were mixed for this segment.

Net revenues were $271 million for the fourth quarter, up 30% from the year-ago quarter and $1.19 billion for the full year, up 14% from the prior year. Trading gains were $53 million for the quarter, up 6% from the year-ago quarter. Commissions and execution fees were $144 million, down 7%. Net interest income was $118 million, up 33% from the fourth quarter of 2014. Brokerage produced $103 million and market making $13 million, with the remaining amount in corporate.

Other income, which includes the effects of our currency diversification strategy, was a loss of $44 million, compared to a loss of $86 million in the prior-year quarter. And for the full year, other income was a loss of $122 million, compared to the loss of $111 million in 2014. This primarily reflects the losses on currency translation and also, non-market making investments with offsetting contributions from market data and exposure fee revenue.

Non-interest expenses were $144 million, up 7% from the year-ago quarter, primarily driven by compensation expenses. For the full year, non-interest expenses were up 36%, driven by customer bad debt expenses. Our other fixed operating costs have remained fairly stable. Within the non-interest expense category, execution and clearing expenses were $54 million, unchanged from the year-ago quarter. Compensation expenses were $56 million, a 14% increase from the year-ago quarter.

And at December 31, our total head count was 1,087, an increase of 13% from the year-end count. About 15% of the year-over-year increase was due to the addition of staff on the purchase of Covestor which closed during the second quarter. Within the operating segments, we continue to add staff in brokerage and cut back in market making.

Customer bad debt expenses had no material impact in the fourth-quarter results, and the full-year expense for bad debts, including the P&L on the related hedging activities, was $128 million, primarily reflecting losses related to the Swiss franc event in January and the late August market turbulence.

As a percentage of net revenues, total non-interest expenses were 53%, and out of this number, execution and clearing expense accounted for 20% and compensation expense accounted for 21%. Our fixed expenses were 33% of net revenues.

Pre-tax income was $127 million, up 72% from the same quarter last year. For the fourth quarter, our overall pre-tax profit margin was 47% as compared to 36% in the year-ago quarter. Brokerage pre-tax profit margin was 52%, down from 64% in the year-ago quarter, and market making pre-tax profit margin was 39%, up from 28% in the year-ago quarter. For the full year, we earned pre-tax income of $458 million on net revenues of $1.19 billion, down 9% from 2014 when pre-tax income was $506 million on net revenues of $1.04 billion.

For 2015, brokerage represented 81% of pre-tax income from the two segments and market making represented the other 19%. 2015 full year overall pre-tax profit margin was 39%, down from 49% in 2014 and for the full year of 2015, pre-tax profit margins were 49% in brokerage and 44% in market making. Comprehensive diluted earnings per share were $0.18 for the quarter, as compared to $0.02 for the fourth quarter of 2014.

On a non-comprehensive basis, which excludes the OCI, diluted earnings per share on net income were $0.25 for the quarter as compared to $0.12 for the same period in 2014. For the full year 2015, comprehensive diluted earnings per share were $0.62 versus $0.51 in 2014. And on a non-comprehensive basis, full year diluted earnings per share were $0.78 versus $0.77 in 2014.

To get a better understanding of the progression of the business, it may be helpful to isolate core operating results, and for this purpose, for the quarter, excluding the currency effects, our core results were as follows. Net revenues were $290 million, down 8% from the year-ago quarter. Pre-tax income was $145 million, down 19% from the same quarter last year and overall pre-tax profit margin was 50%, down from 57% in the year-ago quarter. And I repeat that those are excluding the currency effects only.

Turning to 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 38% and secured margin lending to customers rose 1%, while positions in securities held by our market maker units were pared back by 14%.

According to our announced policy, regular quarterly dividends will continue to temper the capital employed in the market making segment. In the fourth quarter, our market making earnings fell 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.

As a general practice, we hold an amount of cash on hand to provide us with a buffer should we need immediately available fund for any reason. At December 31, we maintained over $3 billion in excess regulatory capital in our broker-dealer companies around the world, of which about 64% is in the brokerage segment. We continue to carry no long-term debt.

And our consolidated equity capital at December 31, 2015, was $5.34 billion, of which approximately $3.5 billion was held in brokerage, $1.7 billion in market making and the remainder in the corporate segments.

Turning now to the segments, beginning with Electronic Brokerage, customer trade volumes were down modestly across all product types. Cleared customer options and futures contract volumes were down 6% and 5%, respectively and the stock share volume was down 7% from the year-ago quarter. Foreign exchange dollar volume also fell 31% from the year-ago quarter.

In option stocks and forex, DARTs increased, which average order sizes decreased, leading to the drop in contract volumes. Customer accounts grew by 18%, over the total at year-end 2014 and by 3% in the latest quarter.

Total customer DARTs were 641,000, up 4% from the year-ago quarter, but down 6% from the third quarter of 2015. Our cleared customer DARTS which generate direct revenues for the brokerage business were 582,000, up 3% on the year-ago quarter, but down 6% sequentially. The average number of DARTs per account on an annualized basis was 447, down 13% from the 2014 period and 9% sequentially.

Commission revenue fell on a product mix that featured smaller average trade sizes which resulted in an overall average cleared commission per DART of $4.07 for the quarter, down 2% for the year-ago quarter and 2% sequentially. Customer equity grew to $67.4 billion, up 19% from the year end 2014 and up 9% sequentially, and these changes took place during periods in which the S&P 500 Index fell 1% over the year and rose 6% over the last quarter. The source of this growth continues to be a steady inflow of new accounts and customer assets. Our ability to attract larger customers is reflected in the average account equity, which grew 1% over the year to $204,000.

After a pullback by customers financing stock purchases in the third quarter, margin debits continued to build, increasing 1% over the year and 8% sequentially. Customer credit balances which increased 17% during 2015 also continue to grow progressively, though spread compression, especially in certain foreign currencies persists in restraining net interest income. Lower trade volumes across the product types resulted in top line revenue from commissions and execution fees of $144 million, a decrease of 7% from the year-ago quarter and 14% sequentially.

These revenues are spread mainly across options, futures, stocks and foreign exchange. Net interest income rose to $103 million, up 21% from the fourth quarter of 2014 and 1% sequentially. Low benchmark interest rates, which continue to compress the spreads earned by our brokerage unit, have been offset by steadily higher customer credit balances in each successive period. 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 security lending utilization to capture more revenue from lending hard to borrow stocks. Net interest income as a percentage in net revenues rose to 47% from 33% in the year-ago quarter, as our brokerage revenues are increasingly diversified between commissions and net interest income. With the growing customer asset base, we believe we are well positioned to benefit from the rising rates.

The Fed's 25 basis point increase in the Fed funds target rate in this December will have a beneficial impact on net interest income going forward. Based on current balances, we estimate that a general rise in overnight interest rates of 25 basis points would produce an additional $57 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 less a narrow spread.

Other income was diminished by mark to market losses on investments of customer funds in US government securities held in segregated custody accounts. These investments, which currently have an average duration of about one year, earn coupon interest at high rates relative to the overnight rates on which we pay customers.

As Thomas mentioned, as the market prices fluctuate, we must recognize the mark to market gains and losses. It's worth noting again that under accounting rules broker dealers are required to record these gains and losses, while banks are not. We consider these gains and losses temporary, because we intend to hold these securities to maturity. The impact on other income was a loss of $52 million for the fourth quarter and $33 million for the full year.

Execution and clearing fees expenses decreased to $35 million for the quarter, down 10% on the year-ago quarter and 22% sequentially, driven by lower volume and continued routing of orders to lower cost destinations, partially offset by higher market data costs. Fixed expenses increased to $70 million, up 30% from the year-ago quarter, driven by compensation and to a lesser extent, advertising expenditures.

Pre-tax income from Electronic Brokerage was $113 million for the fourth quarter, down 32% on the year-ago quarter and 39% sequentially. For the full year 2015, pre-tax income from brokerage was $536 million, down 9% from the prior year.

Excluding items we would consider to be outside the core brokerage business, that is the losses on the Swiss franc event and the temporary mark to market losses on the US government securities, brokerage pre-tax profit in 2015 versus the prior year grew 15%.

Taking a look at the market making segment, market making trade volume was up 5% from the prior-year quarter, though mixed across the product types. Options contract volume was down 14%, while futures contract volume and stock share volume were up 17% and 19%, respectively. Trading gains from market making for the fourth quarter of 2015 were $53 million, up 6% from the year-ago quarter.

Pre-tax income from market-making was $27 million, up 80% from the year-ago quarter and for the full year 2015, pre-tax income from market making was $130 million, up 14% from the prior year. Execution and clearing fees expenses increased to $18 million for the quarter, up 20% from the year-ago quarter. And fixed expenses increased to $24 million, up 4% from the year-ago quarter.

In the corporate segment, the earnings reported for this segment reflects the effects of our currency diversification strategy. Our overall equity as measured in US dollars was decreased by the strength in the US dollar against all 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 $269 million for 2015, because $64 million of this loss is reported as other comprehensive income, this leaves a loss of $205 million to be included in reported earnings. This loss is a primary component of other income in the corporate segment.

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

Question-and-Answer Session

Operator

Our first question comes from Chris Harris from Wells Fargo. Your line is open.

Chris Harris - Wells Fargo Securities

Thank you, guys. A couple of clarifying questions maybe to start, can you provide us with a breakout between net interest income and other income at the broker in the quarter?

Thomas Peterffy - Chairman and CEO

Paul.

Paul Brody - Group CFO

Yes. Between net interest income for the quarter we reported is a $103 million and the other income is a loss of $28 million and that was combining a number of other income items, but the largest item in there is the $52 million mark to market loss in the fourth quarter on those – on the US government securities which we consider temporary. Those will return to par.

<u>Chris Harris</u> - Wells Fargo Securities

So, that's just at the brokerage segment, those two numbers?

<u>Paul Brody</u> - Group CFO

Yes.

<u>Chris Harris</u> - Wells Fargo Securities

Okay. How should we be thinking about a good run rate for other income, excluding these temporary marks on your treasury securities?

<u>Thomas Peterffy</u> - Chairman and CEO

Well, it's roughly $20 million to $30 million.

<u>Chris Harris</u> - Wells Fargo Securities

Okay.

<u>Paul Brody</u> - Group CFO

But in that context, it can be dominated by the currency translation move and perhaps by the mark to market on these on the government treasury holdings.

<u>Chris Harris</u> - Wells Fargo Securities

Got it, okay.

<u>Thomas Peterffy</u> - Chairman and CEO

Excluding those two, yes.

<u>Paul Brody</u> - Group CFO

Yes.

<u>Chris Harris</u> - Wells Fargo Securities

All right. Different question regarding sort of trends that are going on, you did allude to the fact that China or Asia broadly is having a little bit of impact on your trading activity and the margin borrowing, obviously, we've talked about that before, maybe you can share your perspective on why it's not impacting your accounts or seemingly not impacting your accounts, any thoughts on that?

Thomas Peterffy - Chairman and CEO

Well, it is my belief that while the currency – the value of the currency is falling, people would like to have as much currency invested in as many different assets as possible. And so, they want to invest in stocks outside, and we are very good vehicle for that. Even if they want to invest in different currencies, we are a very good vehicle for that. So, I think that more than counterbalances the economic slowdown that's going on there.

Chris Harris - Wells Fargo Securities

Got it, okay. Well, that's interesting, because you would think the volatility going on there may have wiped some people out which would have some --

Thomas Peterffy - Chairman and CEO

I think they are different people.

Chris Harris - Wells Fargo Securities

Yes. I know, that's clearly if that's the situation, yes. Alright and then I did want to sort of ask the question about your commission per DART in brokerage, why do we see such a decline this quarter and just trying to frame up what might be the outlook for that?

Thomas Peterffy - Chairman and CEO

So, our commissions substantially depend on how large the trades are and I spoke – said, in the last quarter, we saw smaller size trades. It is also the case that our introducing broker customers are one of the fastest customer – fastest increasing customer types. And as I have said several times, the way we charge these introducing brokers is that all the trades that the introducing customers do are aggregated for purposes of determining the volume tier. And therefore, introducing brokers with many customers end up paying very, very low fees, very, very low commissions for their trades and that is what enables them to charge maybe not even more than we charge our end clients and still make about 80% of the – retain 80% of the total commission that the end client pays.

Chris Harris - Wells Fargo Securities

Thank you.

Operator

Our next question comes from Rich Repetto from Sandler O'Neill. Your line is open.

Rich Repetto **-** Sandler O'Neill

Yes. Good evening, Thomas, good evening, Paul.

Thomas Peterffy - Chairman and CEO

Hi.

Rich Repetto **-** Sandler O'Neill

I guess the first question is on the treasury mark to market and just to understand the mechanics, could you mention where you invest customer cash that are in segregated accounts, is there any way possible – is there a way, like, if a customer does cash out, are you forced to liquidate the treasuries or is it in aggregate or just a high probability that these things are going to be kept to full maturity?

Thomas Peterffy - Chairman and CEO

So, it is a very high probability that it will be kept to full maturity, because we have several billion dollars that we just keep in cash.

Rich Repetto **-** Sandler O'Neill

Okay.

Paul Brody - Group CFO

So, the treasury portfolio rolls off frequently. So, in other words, it‘s laddered it’s not in a bullet that goes out to a faraway date.

Rich Repetto **-** Sandler O'Neill

Sure. Well, I hear the answer. So, it is a high probability that you will recoup these losses over time.

Thomas Peterffy - Chairman and CEO

It is a – we are almost 100% certain.

Rich Repetto **-** Sandler O'Neill

Got it. And then I guess the next question is – I understand how you explained, Thomas, the impact of what you believe the Asian traders will get into other currencies and trading US stocks etcetera. Has there been any marked difference in any of the trading you see to impact from Asia in the first two weeks of January here in 2016?

Thomas Peterffy - Chairman and CEO

Not really. I mean the trading volume has generally increased from all corners of the world.

Rich Repetto - Sandler O'Neill

Understood, okay. And then, Paul, one sort of – I don't know whether you have this available, but the net interest income split between what you derive from customer cash, customer margin and security lending, is there any way possible you can sort of break those out by the three things, three components?

Paul Brody - Group CFO

Not on this call right now, but I take your request seriously and we are always thinking about how to display our information when we do our quarterly filing. So, we'll consider whether we want to be able to be more precise on those.

Rich Repetto - Sandler O'Neill

Thank you. And one last question would be – so the metric, and I understand the smaller trade size and I understand the commission rate being introducing brokers as well as a smaller trade size, is there any way could one effect also be that the trading of low-priced stocks and high volume, but low-priced stocks has had an impact on the metrics especially as Singapore has sort of cleaned up its act on that type of trading?

Thomas Peterffy - Chairman and CEO

Well, I haven't specifically noticed a substantial increase or a decrease in low-priced stock trading as percentage or overall. So, I do not think that that is the result for the decline in per trade commission rate.

Rich Repetto - Sandler O'Neill

Understood. Thank you very much.

Operator

Our next question comes from Chris Allen from Evercore. Your line is open.

Chris Allen - Evercore ISI

Afternoon, Thomas and Paul. I guess maybe to just start, Thomas, as you discussed kind of the seasonal slowdown in account growth in December and it usually ticks back up at the start of the year, does it follow that pattern so far in 2016?

Thomas Peterffy - Chairman and CEO

I don’t want to talk about events past the end of the year.

Chris Allen - Evercore ISI

Got it, okay. And then just for some clarity on China, you talked about the impact of the currency and clients wanting to have money in different stocks and different currencies, I mean, is the impact that you see is specifically from accounts within China or is it the impact of China more broadly in terms of your overall account base, because as I understood it, I don’t think there was a material level of accounts directly out of China’s mainland?

Thomas Peterffy - Chairman and CEO

I’m sorry. I didn’t understand the question. Okay. Could you restate it please?

Chris Allen - Evercore ISI

The impact that you noted of China in terms of impacting margin levels and customer equity over the course of the year, I’m just wondering if you are talking specifically around accounts and customer assets within China or just the broader impact of China into different accounts and regions more globally?

Thomas Peterffy - Chairman and CEO

When I say what – what really – do I talk about accounts inside China, when I say what?

Chris Allen - Evercore ISI

I’m just – when you talked about it, I think it was precipitous decline early in your comments.

Thomas Peterffy - Chairman and CEO

Yes, but – okay. When I mentioned that there was a large decline in margin loans and account equity, I was generally addressing the accounts from countries in the region. Hong Kong, for example, is a very large – we have very many accounts from Hong Kong in addition to China, and Singapore and Japan and so forth.

Chris Allen - Evercore ISI

Got it. Okay, and I just wanted to be clear of that. That’s it for me. Thank you.

Operator

Our next question comes from Rob Koehn from Ivy Lane Capital. Your line is open.

Rob Koehn - Ivy Lane Capital

Hi, guys. Thanks for taking my call. So, sorry to ask about this again, but just to put a finer point on the treasury marks, could we just – Paul, would you mind just telling us pro forma for the $52 million of treasury marks in the quarter, what the electronic brokerage net revenues and pre-tax income would look like? I mean, is it just $219 million plus $52 million is $271 million and pre-tax is $162 million?

Paul Brody - Group CFO

So, the $52 million is all in the brokerage segment. If you simply add it back to the numbers we reported, that would be normalized for this impact.

Rob Koehn - Ivy Lane Capital

Okay. So $271 million of net revenue, because that comes out of the revenue line, correct? Right?

Paul Brody - Group CFO

That comes out of a revenue line, yes. Right. So, you could say – yes, that would be normalized to $271 million.

Rob Koehn - Ivy Lane Capital

And then $52 million more to the pre-tax income, so you're at $165 million?

Paul Brody - Group CFO

Yes.

Rob Koehn - Ivy Lane Capital

Okay, I think that's sort of the – I mean when you think about presentation going forward, I think maybe that's the kind of thing that is very confusing because I know that's a page that people focus on, that page six. And obviously, the net interest income excluding that was probably a lot better than what people were expecting. Okay. So Thomas, somebody else asked you about the seasonality of new accounts. Is there anything that you're seeing or that you can talk about that you're seeing in terms of the typical size of the new accounts changing over time? That's one thing that is hard to tease out of the monthly metrics is the – if market moves affecting asset levels in total, what are you seeing in terms of --

Thomas Peterffy - Chairman and CEO

I do not see – new account fundings, the size of fundings per account hasn't changed much.

Rob Koehn - Ivy Lane Capital

Okay.

<u>Thomas Peterffy</u> - Chairman and CEO

No, it hasn't changed.

<u>Rob Koehn</u> - Ivy Lane Capital

Okay. And so typically, I think what you've said you'd seen before was like, maybe it starts at $100,000 or $120,000 on average and then grows quickly after that when they transfer in more assets?

<u>Thomas Peterffy</u> - Chairman and CEO

Yes. Generally, the average account size is around – upon funding, it's generally – the average is about $120,000 and in the next six months, it goes up to about a $180,000 and in the fullness of time to about $200,000 and change.

<u>Rob Koehn</u> - Ivy Lane Capital

Got you, okay. What do you think accounts for the seasonality that we've seen in the last couple of years and new account growth being really super strong, particularly strong in the first three to four months of the year? Is that just kind of first quarter activity and --

<u>Thomas Peterffy</u> - Chairman and CEO

I have no idea. For some reason, other people – I guess don't want to think about their savings at Christmastime. I don't know.

<u>Rob Koehn</u> - Ivy Lane Capital

Okay, okay, just curious. And you mentioned that you are planning to, or it sounds like you're about to expand that Scottrade relationship. Is there anything more you can say on that? I mean, that's obviously a big firm with a lot of accounts, so what is the goal there with Scottrade?

<u>Thomas Peterffy</u> - Chairman and CEO

Well, it's not only with Scottrade. So, generally – first of all, we get many more introducing broker accounts from outside the United States so far and people in many of these countries, this is a new kind of a business, because they haven't done it before. So, we get many of them from West Asia and Eastern Europe and the Balkans and South America and people seem to open brokerage accounts and try to grow their business. So, it is – we are very high on that. I think it is going to become very, very substantial, because many of these are new businesses and people go into that business and they will work on that business for years to come. So, it's very good for us.

<u>Rob Koehn</u> - Ivy Lane Capital

Okay. So you can't really say anything about Scottrade in particular right now?

Thomas Peterffy - Chairman and CEO

No, I can’t.

Rob Koehn - Ivy Lane Capital

Okay, okay. And thanks very much for the market share data, it was very helpful. I think particularly the hedge funds at 0.2% and RIA investment advisors at 0.1%. I guess what's even mean more meaningful though would be trying to quantify what is a percentage point of market share worth in each of these areas in terms of revenue? Have you been able to estimate that, or?

Thomas Peterffy - Chairman and CEO

I could, but I haven’t.

Rob Koehn - Ivy Lane Capital

Okay. I mean, it seems like a percentage point of market share in the hedge fund world would be hundreds of millions of dollars of revenue just back of the envelope, but would love to hear more about that maybe in the future.

Thomas Peterffy - Chairman and CEO

So, hedge fund commissions, we have gathered last year roughly $50 million or 0.2%. So that would mean that it would be $250 million, that’s the commission income only, $250 million per percent.

Rob Koehn - Ivy Lane Capital

$250 million per percentage point of market share?

Thomas Peterffy - Chairman and CEO

Right.

Rob Koehn - Ivy Lane Capital

Okay, great. And what is the – I know that you have to add – every now and then you have to add a little bit of fixed expense, but what would you say the contribution margin is on additional commission revenue and brokerage? So the incremental margin, the margin you receive on incremental commissions. I mean, is it 90% or higher?

Thomas Peterffy - Chairman and CEO

It is difficult to isolate from other growing expenses, many of which have to do with the rapid expansion of our legal department.

<u>Rob Koehn</u> - Ivy Lane Capital

Got it, okay.

<u>Thomas Peterffy</u> - Chairman and CEO

And so I don't know to what extent we will have to grow that anyway and to what extent we need to do that because of the growing business.

<u>Rob Koehn</u> - Ivy Lane Capital

Okay, okay. So I guess maybe last question. To what extent, and I probably know the answer to this, but to what extent do you ever – how often do you think about raising prices? I mean, I know for me as a customer --

<u>Thomas Peterffy</u> - Chairman and CEO

I think about it almost every day and I always say I will never do it.

<u>Rob Koehn</u> - Ivy Lane Capital

Okay. I mean, I think there are a lot of people out there that have nowhere else to go, and so they might –

<u>Thomas Peterffy</u> - Chairman and CEO

I don't want to be like Oracle.

<u>Rob Koehn</u> - Ivy Lane Capital

You don't want to be like who?

<u>Thomas Peterffy</u> - Chairman and CEO

Oracle.

<u>Rob Koehn</u> - Ivy Lane Capital

Oracle, okay. Okay, I think that's it for me. So thanks very much guys, appreciate it

<u>Thomas Peterffy</u> - Chairman and CEO

Thank you.

Operator

Our next question comes from Mac Sykes from Gabelli. Your line is open.

Mac Sykes – Gabelli & Company

Good evening, gentlemen.

Thomas Peterffy - Chairman and CEO

Hi.

Mac Sykes – Gabelli & Company

Thank you for the additional color on the client segments, it was very helpful. And just to get back to China a little bit, what are some of the rules associated with opening accounts over there and capital flows? Are there any constraints to the amount that can be funded in an individual account?

Thomas Peterffy - Chairman and CEO

Yes, there are – it is currently $50,000 per individual per year – per person per year.

Mac Sykes – Gabelli & Company

Okay. And has your marketing or your sales efforts and kind of the reason changed at all given the volatility opportunity you think the last couple of months?

Thomas Peterffy - Chairman and CEO

Has the marketing changed? No. We haven't really changed the marketing much, no.

Mac Sykes – Gabelli & Company

Okay. Great, thank you.

Operator

Our next question comes from Conor Fitzgerald from Goldman Sachs. Your line is open.

Conor Fitzgerald - Goldman Sachs

Thanks. Just going back on the market share statistics, which, again, thanks for sharing, I was wondering how much capital you think you need to support the growth in the hedge funds space.

So, the market share statistics you gave do you think you could envision most of your excess capital being used to support growth in this channel over time?

Thomas Peterffy - Chairman and CEO

We would like to, currently as you heard, we have $3 billion of excess. So, I think that if the business grows to the point where we need to use all of our $3 billion, our profits will be sufficient to support further growth.

Conor Fitzgerald - Goldman Sachs

That's helpful, thanks. And then maybe just going back to net interest income for a minute, I know you talked about the growth of the client balances. But were there any other drivers here that kind of drove the increase quarter over quarter?

Thomas Peterffy - Chairman and CEO

Well, the client balances increase the interest income, but it’s the number of clients that increase commission income. Our commission income is roughly, it’s more than 50% of our income.

Conor Fitzgerald - Goldman Sachs

Got it, understood. Thanks and that's it for me. My other questions have been answered.

Operator

And I am showing now further questions at this time. I would like to turn the call back over to Mr. Bill Cavagnaro for closing remarks.

Bill Cavagnaro- IR

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