Research Update:

IBG LLC Outlook Revised To Stable From Positive On COVID-19 Headwinds; Ratings Affirmed

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Overview

- COVID-19-related market and economic stress increases uncertainty and the potential for losses and reduced profitability for IBG LLC as well as most financial institutions.
- However, we expect IBG's very strong capitalization, good risk management, reduced market-making activity, low cost basis, and strong client trading revenue to support profitability, risk-adjusted capitalization, and liquidity under our current COVID-19 scenario.
- We are revising our outlook on IBG LLC and its subsidiary Interactive Brokers LLC to stable from positive. We are also affirming our 'BBB' issuer credit rating on IBG LLC and our 'BBB+' long-term and 'A-2' short-term issuer credit ratings on Interactive Brokers LLC.
- The stable outlook reflects our expectation that IBG will maintain very strong capitalization and supportive profitability and liquidity in the face of our latest COVID-19-related market and economic stress assumptions.

Rating Action

On May 4, 2020, S&P Global Ratings revised its outlook on IBG LLC and its subsidiary Interactive Brokers LLC to stable from positive . At the same time, we affirmed our 'BBB' issuer credit rating on IBG LLC and our 'BBB+' long-term and 'A-2' short-term issuer credit ratings on Interactive Brokers LLC.

Rationale

We revised the outlook to stable from positive to reflect that while we expect IBG to remain highly profitable and capitalized, uncertainty over the length and severity of COVID-19-related market and economic stress raises the potential for losses, to the extent that we are unlikely to raise our ratings on IBG until the COVID-19 threat has receded.

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

IBG is a holding company that, through its regulated broker-dealer subsidiaries, is a major global electronic broker serving both retail and institutional clients. We believe IBG's market position and profitability benefit from its technology-enabled, low-cost provider status, which supports unique, low-cost, and high-functionality offerings. While the firm's brokerage has been the leader in daily average revenue trades, it is substantially smaller than its main retail peers in terms of total client assets, with $179.8 billion as of April 30, 2020.

While cuts in the federal funds rate have decreased net interest income, we expect the firm's profitability to remain solid, with pretax margins remaining well above 40%. Unlike its discount brokerage peers, IBG still charges commissions on most of its trades. IBG's "commission-free" option, which remains much smaller than its traditional commission-charging platform, is largely revenue neutral because of offsetting revenue. Also, unlike many retail brokerage peers, IBG does not have material asset-based fee accounts, the revenue on which has been hurt by the decline in markets.

That said, we believe COVID-19-related market and economic dislocation increases the potential for additional stresses. For instance, these factors could cause further losses similar to IBG's recent loss on clients' positions in oil futures. On April 20, energy markets demonstrated extraordinary price activity in the New York Mercantile Exchange West Texas Intermediate Crude Oil contract, when the May 2020 contract dropped to an unprecedented negative price. Several IBG customers held long positions in contracts on the CME and ICE Europe, which use this contract price for determining the settlement price for cash-settled contracts and futures, and as a result, customers incurred losses in excess of the equity in their IBG accounts. IBG fulfilled its required variation margin settlements with the respective clearinghouses on behalf of its customers and recognized an aggregate provisionary loss of approximately $88 million.

While this did not erode IBG's capitalization or liquidity in any material way, it is indicative of the potential for COVID-19-related stress to spur unusual market movements that cause losses. This potential loss follows a $44 million loss on margin loans linked to a NASDAQ-listed stock last year. We are affirming the ratings because IBG has plenty of capital to absorb potential losses, with approximately $4 billion of capital in excess of the amount necessary to maintain a risk-adjusted capital (RAC) ratio above our 15% threshold for the current ratings.

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

Outlook

The stable outlook reflects our expectation that IBG will maintain very strong capitalization and supportive profitability and liquidity in the face of our latest COVID-19-related market and economic stress assumptions. We expect the firm will maintain its RAC ratio well above 25%, gross stable funding ratio in excess of 110%, and a liquidity coverage metric above 90%.

Upside scenario

Over the next 12-24 months, we could raise the ratings on IBG once COVID-19 stress has abated, and if we expect:

- The firm's growth of less confidence-sensitive brokerage clients and shrinking market-making business to bolster its business and financial stability;
- The firm's new pricing option to not materially erode profitability;
- Management to remain committed to holding very strong levels of capital and to successfully manage its margin loan exposures with minimal losses; and
- The firm's options market-making risk to run down materially.

Downside scenario

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

Ratings Score Snapshot

IBG LLC issuer credit rating: BBB/Stable/--

Interactive Brokers LLC issuer credit rating: BBB+/Stable/A-2

GCP: bbb+

- Anchor: bbb-
- Business position: Adequate (0)
- Capital, leverage, and earnings: Very strong (+2)
- Risk position: Adequate (0)
- Funding and liquidity: Adequate/Adequate#High (0)
- Comparable ratings adjustment: 0

External influence: -1

- Government influence: 0
- Group influence: -1
- Rating above the sovereign: 0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017

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

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
IBG LLC		
Issuer Credit Rating	BBB/Stable/--	BBB/Positive/--
Interactive Brokers LLC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Positive/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.