Interactive Brokers Group (IBKR)

Q2 2016 Results - Earnings Call Transcript

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Executives

- Thomas Peterffy – Chairman and CEO
- Paul Brody - CFO
- Nancy Stuebe - IR

Analysts

- Rich Repetto - Sandler O'Neill
- Chris Allen - Buckingham Research
- Mac Sykes - Gabelli
- Rob Koehn - Ivy Lane Capital
- Doug Mewirther - SunTrust
- Chris Harris - Wells Fargo
- Conor Fitzgerald - Goldman Sachs

Operator

Good day, ladies and gentlemen and welcome to the Interactive Brokers Group Second Quarter Financial Results Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct the question-and-answer session and instructions will follow at that time. [Operator Instructions]

I would now like to introduce your host for today's conference, Ms. Nancy Stuebe. You may begin.

Nancy Stuebe

Thank you, operator. Welcome everyone to our second quarter earnings call. Our earnings were released today after the market close and are also available on our Web site. Our speakers today are Thomas Peterffy, our Chairman and CEO, and Paul Brody, our Group CFO. They will start the call with some prepared remarks about the quarter and then we'll take your questions.

As a reminder, today's call may include forward-looking statements which represent the Company's belief regarding future events, which by their nature are not certain and are outside of 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 the 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

Good afternoon and thank you for joining us to review our second quarter 2016 results. Our pre-tax profit for the quarter was $213 million. Of this amount, $191 million was generated by brokerage, $5 million by market making, with the remainder of $17 million from Corporate, primarily the currency translation. The overall impact of holding our equity in proportion to the basket of currency we call the GLOBAL was a loss of less than $2 million. Our pre-tax profit margin was a robust 58%, despite the pullback in margin loans and lower market volatility compared to the first quarter.

The big news for the quarter was BREXIT. We had begun preparing for the possible outcomes early in the year by adding the event to our event risk scenarios, which are under regular evaluation by our Risk Committee. We started to adjust margin requirements on the relevant products, first initial margins, so as to prevent the establishment of risky new positions, and later increased maintenance margins. Using this approach, very few existing positions needed to be liquidated.

Accordingly, for Interactive Brokers BREXIT was business as usual. We experienced no credit losses and the increased volatility was a positive for our brokerage business. We heard that several brokers suffered outages in the first 2 market days following the vote. We had no such problems. Our volumes were up, but only about 40% over the usual. We generally plan for volume spikes about 300% above normal run rates.

During the quarter, we were favorably impacted by the continuing increase in the marked-to-market volume of Treasury bills in which we invest our customers' cash positions. As we explained in our January earnings call, in the fourth quarter we took a large loss for marking our Treasury portfolio to market, and we continue to make up that loss, with $14 million coming back this quarter on top of the $37 million gained back last quarter.

At the June meeting of the Federal Reserve, there was no rate increase and the market seems to reflect the belief that global headwinds make any increase in the near-term less likely. While these lower benchmark interest rates compress the yields we can earn, these have been to some extent offset by other factors.

First, our customers' credit balances have moved steadily higher in each successive quarter and our policy of investing such cash deposits in short-term Treasury securities has provided a correspondingly higher stream of interest income.

Second, our Stock Yield Enhancement Program, where we lend out our customers' fully paid securities, and assume the associated risk, also provides an additional source of interest revenue, one that we share with our participating customers.

During the quarter, we have again seen several new records for our brokerage business. We continue to hit all-time highs in customer accounts, which were up 15% this quarter to 357,000. While margin loans were flat with the first quarter, with customers reluctant to take on more risk in the face of global economic uncertainty, our customer equity continued to grow to a record of $74 billion.

In fact, over the past five years, we have more than doubled our customer accounts, while our customer equity has nearly tripled. Daily average revenue trades of 649,000 is a record, it's a second quarter high and our third highest quarter.

We see an excellent environment for the continuing rapid growth for our brokerage business for several reasons. As you know, over the years we have invested most of our resources to develop our basic technological infrastructure, with special emphasis on providing our customers the best platform on which they can maximize their returns with a higher probability than any other platform in existence.

A very crucial part of that is minimizing transaction costs. Transaction costs have finally come to the forefront of the examinations conducted by the Justice Department and the Market Structure

Committee of the SEC. As part of the monthly brokerage metrics we publish at noon on the first business day of each month, we present a calculation of our customers' average all-in execution costs for Reg NMS stocks for the past month.

For the last 12 months this cost, including commissions and fees, has been 0.6 basis points. Meaning that the all-in cost of trading 1,000 shares of a $40 stock, including market impact, has been $2.40.

We hope to be able to convince the SEC to require the creation of this report by all brokers or at least to focus attention on it.

The introduction of the fiduciary rule by the Department of Labor is another event that will benefit the most automated and, as a result, the lowest cost broker and custodian.

In preparation of this rule coming into effect over the next year and a half, we are developing a new set of products to specifically compete for the business of fiduciaries who must put their clients' interest first. We expect to be ready and introduce the product by our next earnings call.

At this time, I would like to introduce a new member of the Interactive Brokers Group of companies, Greenwich Advisor Compliance Services. The firm is staffed with attorneys and other professionals with regulatory expertise and experience. The initial task is to offer registration and compliance services to advisor start-ups, or advisors and brokers becoming newly independent and, with a view to their individual needs and circumstances, to refer them to the most appropriate service providers listed on the Interactive Brokers Marketplace. This is in place today.

Beyond this, they are busily writing specifications, working with our developers on extending our compliance systems.

Our ultimate goal is to provide full compliance services together with our service providers, timely, without errors and at the lowest cost in the industry.

We provide execution and custody on better terms than any other broker. When every dollar and every security goes in and out of every customer's account only through our processes on our platform, then we already have the bulk of the data we need to perform most compliance tasks, real time and with very little additional human effort.

Advisors must be audited to ascertain that they did not do any trades or take fees in violation of rules. Advisors on our platform can’t do that because the technology does not allow them to do so. It is all about building technology, building automation to reduce cost and to benefit our customers.

Finally, it appears that too big to fail is coming to an end.

As we stand here today, we do not know that if any large prime broker got into trouble, would the government rush to save their customers? What we do know is that legislation is in the works to prohibit that.

When such legislation passes, we will finally be the broker of choice to hedge funds who worry about their brokers’ counterparty exposure due to their OTC derivatives positions.

I would like to again emphasis that we neither trade nor custody OTC derivatives. Other than cash foreign exchange and some CFDs strictly backed by stock positions, everything we do is exchange-traded, centrally cleared and daily marked to market. Our risk profile coupled with our

$5.7 billion of shareholders' capital will compare favorably with the credit profit of any prime broker.

Now I must say a few words about market making.

While we have been focusing on our brokerage business, the world has changed and left us behind. Our profits from market making have been shrinking for several years now. $5 million profit for the quarter is the lowest number we have recorded in the past 96 quarters. While this may be an aberration, the long-term trend is clear. We must undertake the project of transforming this business over the coming year and we will.

For those of you who are hoping that this move could result in some special dividend, I am sorry to disappoint.

As I alluded earlier, it is our goal to become recognized as not only the most automated, least expensive and most versatile, but also the most creditworthy prime broker. And in order to do that, we are going to continue to accumulate capital for the foreseeable future.

We are looking forward to the upcoming quarters, in light of the changes coming to our industry and across the world. We continually introduce new capabilities which give more power and control to our customers, such as our Adaptive Algo that gives the user better control over executions; and our Portfolio Analyst tool, where all your accounts can be rolled up into one place – checking, savings, annuity and credit card accounts in addition to your investments - and reviewed for balances, performance and risk.

We have nearly 3,000 clients who signed up with investment managers who are listed on our Investors' Marketplace. And this is just the beginning. We have a long list of opportunities ahead of us.

And now our CFO, Paul Brody will go through the numbers for the quarter.

Paul Brody

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

Overall operating metrics were generally strong in the quarter. Average overall daily trade volume was 1.32 million trades per day, up 8% from the second quarter of 2015.

Electronic Brokerage metrics showed solid increases in the number of customer accounts and customer equity. Total and cleared customer DARTs were up 5% and 6%, respectively, from the year ago quarter. Orders from cleared customers, who clear and carry their positions and cash with us and contribute more revenue, remained at 92% of total DARTs.

Market Making contracts and share volumes were mixed across product types.

Second quarter net revenues declined 5% versus last year, while pretax income was down 11%, for a pretax margin of 58%. Our brokerage results were boosted somewhat by high trading volume and the immediate aftermath of the BREXIT vote, although market making was relatively unaffected. Other market factors had the following impacts:

Market volatility rose. The average VIX rose 29% year-over-year, while actual to implied volatility rose 5%. However, these figures were each down from the first quarter of 2016 by

14%. From a historical perspective, a relatively low VIX does little to drive trading volume and, therefore, brokerage revenues, while both measures affect our market making business. As we observed, volatility had been priced into the market before the BREXIT vote, which resulted in fewer opportunities for our market making business in particular.

The U.S. dollar had a mixed performance against other major currencies in the quarter. As a result, the currency basket in which we keep our equity, which we call the GLOBAL, declined by a minimal 0.03% against the dollar for the second quarter. This resulted in a loss of about $2 million which includes a gain of $17 million reported in Other Income, offset by a loss of about $19 million in Other Comprehensive Income or OCI. We estimate the total impact to earnings per share from the GLOBAL to be a loss of $0.02 for the quarter, with $0.02 gain reported as Other Income and $0.04 loss as OCI.

Medium-term interest rates declined a bit further as the Federal Reserve chose not to act before the BREXIT vote and, with global uncertainty and possible headwinds, its cautious approach to rate increases continues. As a result, mark-to-market gains on our Treasury portfolio were $14 million. Although we plan to hold these securities to maturity, we must as brokers, unlike banks, mark them to market quarterly.

Net revenues were $369 million for the quarter, down 5% on a reported basis from the year-ago quarter. Several factors that fall outside our core operating activities should be considered in comparing the current quarter's revenues to the prior year's.

First, our currency strategy added $17 million, versus $25 million in the year ago quarter. The Treasury portfolio marks-to-market added $14 million to our revenues in the current quarter, as compared to $1 million in the year-ago quarter. Adjusting for these two factors, on a pro forma basis our total net revenues would be $338 million in the current quarter and $361 million in the year-ago quarter, or down 6%. This decrease was driven primarily by lower trading gains in our market making business, partially offset by higher net interest income.

Trading gains were $34 million for the quarter, down 49% from the year-ago quarter. Commissions and execution fees were $152 million, down 3%. Net interest income was $126 million, up 17% from the year-ago quarter, and brokerage produced $118 million and market making $6 million, with the remaining amount in Corporate.

Other income, which as I described earlier includes the effects of our currency diversification strategy and also Treasury portfolio marks, was $57 million, up 4% from the prior year quarter.

Non-interest expenses were $156 million for the quarter, up 6% from the same quarter last year. The rise reflects some general increases in fixed expense categories and the non-recurrence of a recovery of customer bad debt in the prior year period. We continue to closely manage our expenses across the board.

At June 30, 2016, our total headcount stood at 1,169, an increase of 8% over the year-end count. We continue to expand in a few key areas, notably customer service, legal and compliance and software development.

Our reported pretax income this quarter was $213 million, leading to a 58% pretax margin. Excluding the GLOBAL and Treasury portfolio mark impacts, our pretax income would have been $182 million. This compares with second quarter 2015 adjusted pretax income of $214 million, net of the same factors. As adjusted, the overall pretax margin was 54%, versus 59% last year.

Brokerage pretax profit was a reported 62%, as compared to 65% last year, and adjusted for the Treasury portfolio marks, brokerage pretax profit was 60%, versus 65% with the same adjustments in the prior-year quarter.

Market making pretax profit was 12%, versus 42% last year.

Comprehensive diluted earnings per share were $0.36 for the quarter as compared to $0.44 for the second quarter of 2015. On a non-comprehensive basis, which excludes OCI, diluted earnings per share on net income were $0.40 for the quarter, as compared to $0.37 for the same period in 2015. Excluding currency impacts, diluted earnings per share were $0.38 for the current quarter versus $0.33 for the year-ago quarter on the same basis.

Turning to the balance sheet, the 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 that provides us with a buffer should we need immediately available funds for any reason. At June 30, , we maintained over $3.7 billion in excess regulatory capital in our broker-dealer companies around the world, of which about 69% is in the brokerage segment.

We continue to carry no long-term debt and our consolidated equity capital at June 30, 2016 was $5.69 billion, of which approximately $3.8 billion was held in brokerage, $1.7 billion in market making, and the remainder in the corporate segment.

Now we'll look at segment results briefly. In electronic brokerage, customer trade volumes were mixed across the product types. While overall cleared trades rose 10%, cleared customer options and stock share volumes fell 7% and 41%, respectively, while futures contracts rose 4% from the year ago quarter. The decline in stock volume was largely driven by a drop in low-priced stocks trading in Hong Kong, notably, in mainland Chinese stocks that are listed in Hong Kong. Foreign exchange dollar volume was off 3% from the year-ago quarter.

Commission revenue fell 3% on a product mix that featured smaller average trade sizes, which resulted in an overall average cleared commission per DART of $3.91 for the quarter, down 9% from the year-ago quarter, but up 1% sequentially.

Customer equity grew to $73.7 billion, up 12% from last year and up 5% sequentially. The source of this growth continues to be a steady inflow of new accounts and customer assets. As a result, our average account equity rose sequentially to $206,000, though still 4% below the prior year's level.

We continue to attract larger customers along with financial advisors that manage groups of smaller accounts, which results in an account size mix that affects both average trade size and average account equity.

Margin debits fell 21% year-over-year, though remained steady with the first quarter of 2016. Ongoing market uncertainty has caused customers to reduce their leverage, which we first observed in the third quarter of 2015. Customer credit balances, on the other hand, continue their steady growth, rising 16% over the year ago quarter.

Net interest income rose to $118 million, up 11% from last year. Interest income benefited from the Federal Reserve’s increase in the Fed Funds target rate in mid-December as well as our increased customer balances.

Our Stock Yield Enhancement Program, where we share revenues from lending out fully-paid securities with our customers, continues to provide an additional source of interest revenue. And we continue to improve our securities lending utilization to capture more revenue from lending hard-to-borrow stocks.

With a growing customer asset base, we continue to believe we're well-positioned to prudently maximize our net interest income, given the opportunities presented by the market. While we are not expecting any imminent changes in rates, based on client balances, we estimate that a general rise in overnight interest rates of another 25 basis points would produce an additional $43 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.

Fixed expenses in brokerage were $73 million, 22% over the year-ago quarter, largely driven by targeted increases in staff and software development, which are reflected in the employee compensation and general and administrative line items.

Turning to market making, trade volume was mixed across the product types: options contract volume was up 2%, while futures contract volume and stock share volume were down 17% and 22%, respectively. As in brokerage, a substantial portion of the drop in stock volume came from low-priced stocks trading in Hong Kong.

Trading gains from market making for the second quarter were $34 million, down 49% from the year-ago quarter. While market volatility measures were generally favorable, the volatility caused by the outcome of the BREXIT vote had already been priced into the market and did not present us with exceptional profit opportunities.

Execution and clearing fees expenses were down 11%. Fixed expenses decreased to $22 million, down 8% from the year-ago quarter as we continue to pare down the cost of running this business.

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 U.S. dollars, fell slightly as the U.S. dollar strengthened markedly against the British pound and, to a lesser extent, against the Australian dollar and Euro; and weakened against the Brazilian real and the Japanese yen. We estimate the overall loss from our strategy of carrying our equity in proportion to the GLOBAL to be about $2 million for the second quarter of 2016. As I described, because $19 million of the GLOBAL loss is reported as Other Comprehensive Income, this leaves a gain of $17 million to be included in reported earnings.

After the quarter, we made some modest changes to the composition of the GLOBAL, as detailed in our earnings release, which will be reflected in the quarters to come. The second quarter results reflect the former basket's proportions.

Now I'd like to turn the call back over to the moderator so we can take your questions.

Question-and-Answer Session

<u>Operator</u>

Thank you. [Operator Instructions] And our first question comes from the line of Rich Repetto with Sandler O'Neill. Your line is now open.

Rich Repetto

Thomas, good evening, Paul. I guess the first question is a little bit more color on the brokerage expenses and the increase even quarter-to-quarter, the fixed expenses look like they went up a certain amount, a material amount?

Paul Brody

Yes. As I said, primarily it is compensation and software development related. We are in an expansionary mode, and we've been adding resources in particular to customer service, legal and compliance, and software development.

Rich Repetto

Okay. And are you able now to or do we have to wait until the 10-Q for the net interest income breakout?

Paul Brody

We don't have breakout right now for you, but we'd like to be in a position to give you a little bit more color come the 10-Q, so that's our goal. Suffice to say though that as we said before, most of it came from two factors. The increase in credit balances overall, and the fact that the Fed did raise 25 basis points in December and, during the year-over-year comparison, we are up about as much as the previous interest rate sensitivity analysis predicted, plus the additional balances.

Rich Repetto

And I guess my last question is for you Thomas. You talked about over the next year trying to, I don't know what exact words you used, but in regards to the market maker, take a hard look at the business and that capital would probably, I am assuming that capital would be moved to the broker…?

Thomas Peterffy

That depends on what the result of the hard look is, right? So you're saying that if the result of the hard look were to reduce the market making business or maybe even eliminate it that would free up capital and yes, in that case we would hand it over to the broker.

Rich Repetto

Okay. Well I guess what other alternatives, just given the results I guess and what you said in your prepared remarks about the trend of the business, could you see other strategies with the market maker?

Thomas Peterffy

Yes.

Rich Repetto

And what might they be?

Thomas Peterffy

Yes, other strategies could be to either join together with somebody who does frequent trading, profitable frequent trading not in a market maker mode, or to develop that facility for ourselves.

Rich Repetto

And when you say not in a market making mode, so in a proprietary trading type of mode?

Thomas Peterffy

Yes.

Operator

And our next question comes from the line of Chris Allen with Buckingham Research. Your line is now open.

Chris Allen

Just following-up on Rich's question, let's just assume from a scenario perspective that the market making business was shuttered, any color in terms of what level of expenses would still be maintained i.e., would that be transferrable to the brokerage and others - there is technology sharing between the two - I am just wondering what would the impact there be?

Thomas Peterffy

Paul, you got an answer to that?

Paul Brody

I don't have a specific answer. We have done an amount of analysis in that area, so the overall answer is I'll call it a minority portion, we would expect to carry over into brokerage that is sort of in lost synergies and technology and memberships and things like that. But it would be a consumable amount for brokerage.

Chris Allen

Got it. And then any color in terms of the customer growth trends, I mean it's still Asia-Pac outpacing Europe and U.S., is there any change to that dynamic from a regional perspective, do you have any color there?

Thomas Peterffy

We have all of the color you want, what would you like to know? Ask me a specific question I will give you the specific answer.

Chris Allen

Sure - what was the account growth trend by region from a growth perspective?

Thomas Peterffy

Okay. So I can tell you that by region, America is 12%, Europe is 11% and Asia is 29%.

Chris Allen

And from a customer perspective breakdown in terms of the different buckets in terms of advisors, prop, etc. if you can provide the same metrics that'd be great?

Thomas Peterffy

Yes, individuals were 12%, hedge funds were 15%, prop traders were 9%, advisors were 14%, introducing brokers were 29%.

Operator

And our next question comes from the line of Mac Sykes with Gabelli. Your line is now open.

Mac Sykes

The change in currencies that occurred, you say that it's based on relative importance, if you can provide some more color there, is this denomination based on capital, revenue and is the mix forward-thinking in terms of determination of economic impact?

Thomas Peterffy

No, we have eliminated the Brazilian real because we have closed our Brazilian operations. We have eliminated the Korean won because the business in Korea does not seem to grow as well as we were hoping, and it is not a really convertible currency. We have added this to the U.S. dollar and to some extent to the Chinese CNH because China is becoming a more and more significant part of our business, and we are trying to have the currency basket to, on the one hand, reflect the relative importance of these economies and, on the other, to provide us with the sufficient funds and the sufficient currency so we can do things like margin lending for example.

Mac Sykes

And then the Greenwich Advisor Services I hope I said that right.

Thomas Peterffy

Yes.

Mac Sykes

Is this going to be bundled as part of the new relationship with an advisor that comes on the platform or is this going to be sort of independent consultant driven, what's your expectations in terms of revenue for this?

Thomas Peterffy

For the moment, it is bundled but when it's in full force, we will charge for it but we will charge for it less than anybody else in this space, much less, just like we charge much less in commissions and provide better executions. So, the idea is that we have all this stuff automated already, and we compete and we have all the data practically and we're competing with people who have to piece the data together, and so it's going to be very, very easy for us and for others it's not so easy.

Mac Sykes

And then my last question, so when we think about the value of the market making segment, we have the tangible asset which is the capital, maybe you can give us a little color on sort of the amount of personnel that are in market making, maybe some of the intangibles related to it, I don't know whether it's the hardware or the relationships, or anything like that, what other value could you assign to it other than capital at this point if possible?

Thomas Peterffy

Well, the value that it has is that it can obviously get in and out of the markets so that it makes profit rather than be another cost like most other market participants have to pay in order to buy or sell securities. We get a profit from buying and selling securities, but it is not enough. So that's one significant value. The second is that we have systems that can manage very large positions in a hedged manner that is the reason why we in almost a hundred quarters haven't had a loss on positions other than front running of, especially, corporate news. So, in diminishing order the next valuable thing is of course all of our exchanges, all of our memberships in exchanges and clearinghouses and a great deal of know-how and experience.

Operator

[Operator Instructions] And our next question comes from the line of Rob Koehn with Ivy Lane Capital. Your line is now open.

Rob Koehn

Thanks for taking my call. Okay, so Thomas, on the market maker, is one of the options, if I heard you right, to potentially build your own platform like a Virtu type of platform, is that one of the things that you are considering?

Thomas Peterffy

Yes.

Rob Koehn

Okay. And can you talk a little bit more about your thought process on that and how you would make that choice? Obviously technology and algorithms are something where you excel?

Thomas Peterffy

Yes, technology we are good at. We are less good at signal processing which is what this is basically all about. So, I do not know if we can succeed at that, but we certainly can look at it.

Rob Koehn

Okay. I guess a naïve question, how will you assess your ability to succeed without trying?

Thomas Peterffy

We are going to try, but simulated try.

Rob Koehn

Okay. Simulated try. Got it. And did you say that that would be over the next year you will be looking at this, or will it be a shorter period of time to that?

Thomas Peterffy

Yes, we will consider our options, I am giving myself a year to make a decision here.

Rob Koehn

Okay. From an investor's perspective, it’s pretty exciting to have the thought that this eventually becomes a pure-play brokerage company, I think a lot of people been waiting a lot of years for that possibility.

Thomas Peterffy

Yes, that's part of the consideration.

Rob Koehn

So, given that, would you ever consider doing this outside of IBKR, in other words…

Thomas Peterffy

Yes, that's a possibility, yes.

Rob Koehn

So spinning off a Virtu type of operation if you could build it?

Thomas Peterffy

That's a possibility, yes.

Rob Koehn

Okay. So the technology is separable and that is a, it is possible maybe to build a business like that in turn, okay. Great, thank you. And then I guess a separate topic. I read the Financial Times interview you did a couple of months ago, and you predicted that the number of brokers would contract by 80% or something like that? Four-fifths would go out of business. So, is it more the technology cost or is it the regulatory cost?

Thomas Peterffy

It's both, but it is mostly the technology that is brought on by regulations.

Rob Koehn

Okay. And if you look at this swath of 80% of brokers, what is the number of firms, what is that 80% in a natural number?

Thomas Peterffy

As far as I understand, there are 4,000 broker-dealers in the United States.

Rob Koehn

Okay. So, of those brokers, I mean do you think that they become introducing brokers, that they just shut down, I mean presumably they are all selling their order flow, is that a good assumption?

Thomas Peterffy

Well, many of them are selling their order flow, but simultaneously we have certain efforts going on by the SEC and that you may have heard of. This Broker's Score what is it called Broker Scorecard by the SEC chairman's proposal and simultaneously the -- I just participated in a subcommittee of the Market Structure Committee that is currently examining the issue of executions, and so I think that there will be tighter, the requirements will be tightened up here.

Rob Koehn

Okay. And then I guess again and on a separate topic you did the CNBC interview and you talk a lot about what sounds like sort of the Jeff Bezos' flywheel at Amazon, with the lower cost leading to more customers, leading to more trades and then further lower costs. And it seems that's sort of the focus that most of your advertising, but it doesn't seem like you…

Thomas Peterffy

It is not happening is your question.

Rob Koehn

No, my question is how come you don't advertise the platform itself, so the Mosaic platform and its ease of use. I think a lot of people who think about IB think about the old Trader

Workstation and it being a pretty complex system and don't think about, or know about, the Mosaic platform. Why is that?

Thomas Peterffy

It's a difficult question. Well, it is not so easy to advertise it. It's not so easy to tell the story. Everybody tells that what they are doing is the best thing, yes? So, you want me to just go and say that ours is "the best" - nobody will believe that even if it is. It's not factual.

Rob Koehn

Okay, I think it's an opportunity. Okay I'll get back in the queue. Thank you, guys.

Thomas Peterffy

Thank you for the suggestion.

Operator

And our next question comes from the line of Doug Mewirther with SunTrust. Your line is now open.

Doug Mewirther

Hi, good evening. I had a quick question for Paul and then unfortunately one more question on the market maker that's more conceptual. First, Paul, I noticed that your non-controlling interest went down in the quarter. And I'm not sure if it was the same last quarter, I'm just comparing with the beginning of the year. But it looked like your diluted share count went up, but the non-controlling shares didn't go down. And I just wondered what transpired to affect the share count this way, and would this be a continuing trend?

Paul Brody

Yes. This is standard, this happens every second quarter, when our stock incentive plan for employee shares vest in May. So you will always see that, and that has been the case since we went public. So there is a bump and it only affects the public share side, not the non-controlling interest, because these are previously unvested shares that become IBKR shares.

Doug Mewirther

Okay. Thanks. That's very helpful. Thomas, with the market maker, so it sounds that part of the reason, I think, that market making has been so squeezed is because, I mean there has been just no volatility. I mean the VIX is in the teens. So are you saying that even if the VIX goes back to the 20s that the economics would still not be satisfactory at your present configuration?

Thomas Peterffy

So, it's not only that the volatility is very low, but the intra-day volatility is extremely low. So if you look at the market, it either opens up or down and where it opens and it tends to stay there for the day, so it gives us not too much opportunity to trade so you are right on that score, Doug. But we can't ignore the long-term trends. So maybe, what we have is there are a large number of market participants who do very frequent trading, and that seem to be doing rather well or, at least that's the word on the street that they are doing well. And who do they trade with, but us. So the uninformed trades have diminished in frequency, because trading with uninformed traders, because the brokers, the retail brokers are now selling the order flow to Citadeland

Susquehanna and Goldman. And so we end up trading with the informed traders, those who successfully trade for a living. So when I said that maybe we find somebody like that to do something together that is what I meant.

Doug Mewirther

Okay. That's very helpful. Thank you. That's all my questions.

Operator

And our next question comes from the line of Chris Harris with Wells Fargo. Your line is now open.

Chris Harris

Thanks guys. Question on new business opportunities, there is a lot of dislocation happening at the European banks and just wondering if you guys were in dialogue or foreseeing any opportunities stemming from that? I am in particular curious about opportunities in prime brokerage.

Thomas Peterffy

Well, as far as dialogue we don't discuss dialogues. Opportunities, yes we do see opportunities and that goes along the lines of, as I said, more and more brokers realize that it doesn't pay for them to continue to build the technology and do the business on their own rather than using somebody else's. We do not want to become a bank because we don't want all the regulations that banks have to go under, otherwise we pursue that space to the extent we can.

Chris Harris

All right, my one follow-up would be on your pricing strategy, and this is sort of a long-term trend but it looks pretty clear in this quarter as well, but generally speaking it seems like your newer customers are less active than your legacy customers and maybe they're less profitable too, but I am not sure about that. Could you guys envision a scenario where you actually modify pricing for these less active customers, in order to perhaps boost some of these per account metrics, say DARTs per account or revenue per account, excuse me.

Thomas Peterffy

So the issue there is that these less-often trading customers that are less profitable tend to be introducing brokers' customers. And as you know -- so we give these introducing brokers an extremely low price because we bundle all the introducing brokers' customers as though they were one customer, and give them our lower commission tier in proportion to the entire volume provided by the introducing broker. So that is the explanation for that. And to the extent we don't break it out that's why it appears like our commissions per trade or revenue per customer is decreasing. So, maybe in the future you give me an idea, maybe we should break that out.

Chris Harris

Okay, but then I guess what you are saying, it's pretty stable, excluding the introducing brokers?

Thomas Peterffy

That is what I would think, yes.

Chris Harris

Got you. Okay, thank you.

Operator

And our next question comes from the line of Conor Fitzgerald with Goldman Sachs. Your line is now open.

Conor Fitzgerald

Thank you for taking my question. First, could you maybe provide a little more color on some of the products you are thinking about developing for your advisors that they are going to need as they adapt to the fiduciary rule?

Thomas Peterffy

I am sorry, but I really don't want to because you know three months matter here. So if we come out with something and we give three months' notice to our competitors, and they will be competing with us three months earlier.

Conor Fitzgerald

And on the prime brokerage opportunity, there has obviously been a lot written about what's going on in the prime brokerage space for the hedge funds. With what you are seeing on your platform at the beginning of the year, what are you hearing from clients in terms of what they need to execute in these markets in the beginning of the year?

Thomas Peterffy

What do they need?

Conor Fitzgerald

In terms of like changing needs or risk systems et cetera?

Thomas Peterffy

Well you see, we have basically two large disadvantages. One is that we are a relatively new name in the space and we are certainly not too big to fail. And secondly, we do not do over-the-counter derivatives, which from a profitability point of view is an advantage, but from the product base point of view it isn't, because as you know many of the big prime brokerage customers do those things.

Conor Fitzgerald

And sorry just one more cleanup from me, just on the bad customer debt, not a big number this quarter at $3 million, but I don't think I heard any color just on what drove that loss for that expense?

Thomas Peterffy

I'm sorry, Paul what is this?

Conor Fitzgerald

The $3 million…

Paul Brody

I don't think there's anything in particular, the shift also reflected…

Thomas Peterffy

I think it will be last quarter they're referring to, not this quarter?

Paul Brody

In other words, this quarter but sometimes, some of that is -- it is a recognition of when an event happens in each quarter you have to make an assessment of the likelihood of taking a loss, and sometimes those assessments play out over time and so they're sometimes taken in that quarter that's past the quarter in which the event happened. And then the shift from year-to-year is also reflecting the fact that last year, if you recall on January of '15, we had that Swiss Bank event in which we took large losses and we actually recouped some of those in the second quarter. So, the shift somewhat overstates what's going on because we had a recoupment of about $1 million or $1 million plus in the prior year's quarter.

Operator

We have a follow-up question from Rich Repetto with Sandler O'Neill. Your line is now open.

Rich Repetto

Yes I will try to make this short Thomas, but when you said you might look at taking the market maker and having a similar operation to Virtu.

Thomas Peterffy

I didn't use Virtu, I think you did or somebody else did.

Operator

And I'm showing no further questions at this time, I would now like to turn the call back over to Ms. Nancy Stuebe for closing remarks.

Nancy Stuebe

Thank you everyone for participating today. As a reminder, this call will be available for replay on our Web site. We will also be posting a clean version of our transcript on our site tomorrow. Thank you again and we will talk to you next quarter end.