Interactive Brokers Group's (IBKR)

Q3 2017 Results - Earnings Call Transcript

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Executives

Thomas Peterffy - Chairman and CEO

Paul J. Brody - CFO

Nancy Stuebe - Director, IR

Analysts

Chris Allen *Rosenblatt Securities*

Christopher Harris *Wells Fargo Securities*

Conor Fitzgerald *Goldman Sachs Group*

Doug Mewhirter *SunTrust Robinson Humphrey*

Kyle Voigt *Keefe, Bruyette, & Woods*

Mac Sykes *G. Research*

Richard Repetto *Sandler O'Neill + Partners*

Operator

Good day, ladies and gentlemen, and welcome to the Interactive Brokers Group Third Quarter Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

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

Nancy Stuebe

Thank you, operator, and welcome, everyone, to our third quarter earnings call. Our earnings were released today after the market close and are also available on our website.

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?

Thomas Peterffy

Good afternoon, everyone, and thank you for joining us to review our 2017 third quarter performance.

As usual, this quarter will mark several milestones for Interactive Brokers. First, number of accounts, customer equity, average equity per account and margin loans outstanding all hit new records. Our customer equity is now $116 billion, up 40% from a year ago. Our customer accounts are also up significantly at 457,000, up 23%. Furthermore, these metrics continue to grow at an accelerating rate.

As we grow larger, more people hear about Interactive Brokers and look into what we offer. They hear that we do not sell our orders and about the quality of our executions; they see our low commission rates, our high interest payments and our best-in-class technology.

After they sign on as clients, we then benefit from positive word of mouth as they use our platforms and tell their fellow investors about us.

On the new product front, in August, we introduced a debit card that is linked to your account, a product we had been asked for frequently. In one single Interactive Brokers account, you can now borrow, earn, save and invest, completely managing your finances without leaving the platform.

If you choose to borrow on your Interactive Brokers debit card, you borrow at our margin rates of no more than 2.66% to as low as 1.41%. As it has just been introduced, the debit program has much growing to do.

Now that we have introduced the card in the United States, we will expand to Europe and Canada in the next 6 months and to Asia after that. Stay tuned for additional benefits we will offer to our cardholders in the next phases of our rollout as we work to make the IB debit card even more compelling.

We also introduced our new order management system, fully integrated with our Trader Workstation, which offers order management, trading and research as well as risk management, reporting and back-office tools, again -- all from a single platform.

Our customers now do not have to use multiple expensive vendors and systems for their investment management needs. Our OMS will be able to handle everything at low cost to them. Our OMS is available at $100 of commissions per month per seat, at a minimum of 25 seats.

We are in the process of completing our MiFID reporting systems for regulatory compliance in Europe. We are well positioned to cope with these kinds of requirements and look at it as an opportunity to offer it to other brokers.

Finally, having sold the majority of our Market Making operations to Two Sigma Securities, we are now primarily an electronic broker. We have retained some Market Making functions overseas, and a Delta One operation in the U.S. to facilitate our brokerage business, supporting products such as ADR and ETF creation and CFDs.

This transaction closed on September 29th, and we recognized an $11 million gain, which is reported in other income.

We also have an earn-out for 3 years, as a portion of future profits from this business. While we look forward to participating in Two Sigma Securities' success in this business, what is most important to us is that they continue to provide a tight and liquid option market at the various exchanges for our customers, and at the same time, we no longer have the apparent conflict of being an agency broker and a principal trader in the same or similar products at the same time.

It is our sole mission at Interactive Brokers to continually improve the productivity and performance of our platform so we can directly improve the performance of our customers. We accomplish this by focusing on expanding and improving our software and offering state-of-the-art technology and algorithms, all the while having low-cost and transparent pricing and an expanded product base. Our debit card, our OMS and our focus on new brokerage processes continue in this tradition.

As for our financials, we continue to see positive signs. Last quarter, I said it was difficult to imagine that the volatility index, or VIX, would go any lower, and that has proven to be accurate. Late July, August and September showed better volatility levels. However, by the end of the quarter, we saw the VIX falling below 10 again.

Our DARTs rose 14% this quarter versus last year, and our DARTs per account, while down, declined at a much slower pace due to a somewhat stronger trading environment.

Our commission revenue grew 4% from last year as trading levels in stocks, futures and options rose due to an increase in number of accounts.

After 3 Fed hikes over the past year, we now pay 66 basis points on any U.S. dollar cash in customer accounts with assets in excess of $100,000. This is equal to the Feds fund rate, which we use as our benchmark, less 50 basis points. This rate, which we pay on our customer cash, may be withdrawn or spent at any time without notice. It's the highest rate we know in the bank and brokerage space. Banks are paying under 10 basis points on freely available cash, and even though we pay a higher rate, a much higher rate, our net interest income and interest margin grew from last year.

And with Interactive Brokers, any future increase in the benchmark rate will be passed on to our customers.

We recently began a couple of new initiatives which we mentioned last quarter to grow our interest income further. Our bank sweep program for larger customers started testing at the end of September, and should benefit our interest margin results in upcoming quarters. And in the fourth quarter, we will begin investing some of our cash in government-backed instruments to further improve our net interest margins.

Now for our results. Our pretax profit for the quarter was $268 million. Subtracting $37 million for favorable currency, treasury marks and business sale gains leaves $231 million. Of this, $224 million was generated by brokerage, and the market maker earned $11 million. The market maker's results include the $11 million gain from the sale of our option Market Making business to Two Sigma Securities. Any earn-out would show up in future results.

I am sure you will ask me what the earn-out target is and how much we anticipate in future payments, but we did not make such forecasts when we were running that business, and now that we know even less about it than we used to, we will continue not to make any forecasts. All I can tell you is that it will not be negative because we do not share in the losses, should there be any. What I can give you is our statistics on our brokerage business, how it's evolving across our different customer types.

Every one of our customer segments showed strong growth in both accounts and client equity. Individuals now represent 52% of our accounts, 36% of our client equity and 50% of our commissions.

Hedge funds and proprietary trading accounts are 4% of accounts, 21% of customer equity and 25% of commissions. These, our most actively trading accounts and some of our most lucrative, have been growing at a rapid pace throughout 2017. As our hedge fund client equity is growing almost 3 times as fast as accounts, it means that we are attracting, on the average, larger funds with more assets under management.

Registered investment advisers are 18% of our accounts, 24% of client equity and 17% of commissions. Introducing brokers are 26% of accounts, 19% of client equity and 7% of commissions.

This quarter, we completed the migration of Zions Bank customers. A total of 5,400 accounts were transferred, most of them in August. This added to our strength in account growth for the introducing broker segment, though I note this is -- this was a portion -- only a portion and not the bulk of the reason for the strong growth in this quarter.

The bigger reason we have seen strength in these segments is that we fill a broad market need. Registered investment advisers and brokers need an easy-to-use, quick-to-set-up, low-cost platform that can solve their investing, reporting and back-office needs while also growing with them. With us, they get all that, plus a technologically sophisticated platform that they or their customers can use to invest a practically unlimited number of accounts in various products with a few mouse clicks at the same time, at the same prices.

Registered investment advisers and introducing brokers who come to our platform can open up and start to operate their business immediately. Then they can go out and attract new customers despite working in a regulation-heavy industry, while we take care of the back office and most compliance. It is a very attractive situation for them.

This year, we celebrate our 40th year in the business. While we constantly change and improve our platform, we never change our focus to provide investors with the best tools at the lowest cost so they can achieve their best performance.

And now Paul Brody will go over the numbers.

Paul Brody

Thank you, Thomas. Welcome, everyone, to the call. As usual, I'll first review the summary of results, then we'll give segment highlights, and then we'll open it up to questions.

Third quarter operating results reflect a continuing strength in brokerage performance, led by growth in both commissions and net interest income. These were further supplemented by currency translation, and a net reimbursement of exit costs related to the sale of our U.S.-options Market Making business to Two Sigma Securities, which closed on September 29th.

Without those, and other nonoperating items that I'll enumerate a little later, pretax income increased 24% over the prior year quarter.

Volatility still remains at historic lows. Lower volatility generally gives rise to fewer trading opportunities. But while our cleared DARTs per account fell 6% from last year, our quarterly total DARTs were up 14% year-over-year and up 4% sequentially on the strength of continued growth in our account base.

And with the growing contribution of net interest income, average net revenue per account has increased 2% over the prior year quarter. We continue to see robust growth this quarter in asset-gathering and margin balances in brokerage as I'll describe in my comments on that segment's performance. Electronic Brokerage continues to post strong increases in the number of customer accounts and customer equity, up 24% and 40% respectively.

Market Making contract and share volumes were down across product types as we wound down the bulk of this activity, and I'll discuss the market maker further in my comments on that segment's performance.

As reported, third quarter net revenues rose 23% despite being compared to a solid year-ago quarter with higher volatility. Reported pretax income was up 46% for a pretax margin of 63%.

Excluding items such as investment in U.S. Treasuries, currency translation effects and one-time payments and charges in Market Making, net revenues were up 11% versus last year, while pretax income was up 24% for a pretax margin of 60%. The main factors this quarter were low market volatility and, as Thomas mentioned, the average VIX fell 17% year-over-year, and actual to implied volatility also fell 13% from the prior year quarter. Generally, a low VIX dampens trading volume and therefore brokerage revenues. Second, the U.S. dollar weakened versus most other major currencies. As a result, the currency basket in which we keep our equity, which we call the GLOBAL, rose 0.6% against the dollar for the quarter, resulting in a gain of $32 million.

$26 million of this is reported as income and $6 million is Other Comprehensive Income or OCI. We estimate the impact for the quarter on earnings per share from the GLOBAL to be a gain of $0.06 on comprehensive earnings and $0.05 on net income.

Finally, the U.S. dollar benchmark interest rates were unchanged in the quarter. However, we observed the full effect of the Federal Reserve's last hike in mid-June. We continue to allow the duration of our portfolio to shorten in order to reduce our yield curve exposure. As a result, we had a small mark-to-market gain on our Treasury portfolio of only about $1 million. Although we plan to hold these securities to maturity, we must, as brokers, unlike banks, mark them to market in our financial reporting.

I'll summarize the quarter's revenues, adjustments and pretax results as follows: Reported net revenues for the quarter were $426 million. Adjusting for noncore items, we deduct the $26 million gain on our currency strategy, the $1 million gain from marking our Treasury portfolio to market, and an $11 million cost recapture for running the options market maker during the transition to Two Sigma Securities. This results in adjusted net revenues of $388 million for the quarter, an increase of 11% from adjusted net revenue of $349 million in the year-ago quarter.

Reported pretax income was $268 million. And adjusting for nonoperating factors, pretax income was $231 million. That's an increase of 24% from adjusted pretax income of $187 million in the year-ago quarter. Pretax income in the latest quarter was 63% -- pretax margin, rather, was 63% as reported and 60% as adjusted.

Turning to the income statement line items. Commissions were $163 million, up 13%, primarily driven by higher stock and options volumes. Net interest income was $182 million, up 34%. Brokerage produced $171 million and Market Making $8 million, with the remainder in Corporate. The benefit of the Federal Reserve rate hike in mid-June is reflected in these numbers. Trading gains were $11 million, down from $38 million in the year-ago quarter, and the winding down of our market maker led to reduced trading levels.

Other income, which, as I described earlier, includes the effects of our currency diversification strategy, Treasury portfolio marks and cost recapture on the sale of U.S.-options Market Making, was $70 million.

Noninterest expenses were $158 million for the quarter, down 2% from the same quarter last year. The decline was spread across a number of expense categories, primarily reflecting the wind-down in Market Making and also lower bad debt expense.

At September 30, 2017, our total headcount stood at 1,186, a decrease of less than 1% over the year-ago quarter and a 2.5% decline sequentially. Versus the year ago, we have expanded in a few key areas, notably in customer service, and the sequential decline reflects terminations related to the Two Sigma closing and a lower level of hiring as we transfer certain staff members from Market Making to Brokerage.

Comprehensive diluted earnings per share were $0.44 for the quarter as compared to $0.30 for the third quarter of 2016 on a noncomprehensive basis, which excludes OCI. Diluted earnings per share on net income were $0.43 for the quarter as compared to $0.30 for the same period in 2016.

Excluding the impact of noncore items, comprehensive diluted earnings per share were $0.37 for the current quarter versus $0.30 for the year-ago quarter on the same basis.

As we have in the past few quarters, to help investors better understand our earnings, we will break out our pretax income so that you can see the split between the public shareholders and the noncontrolling interests.

Starting with income before income taxes of $268 million, we deduct $7 million of income taxes paid by our operating companies, which are predominantly foreign taxes. That leaves us with $261 million, of which 82.7%, or that $216 million reported on our income statement, is attributable to noncontrolling interests. The remaining 17.3% or $45 million is available to the public company stockholders. GAAP accounting prevents us from putting this $45 million number on our income statement.

After we expense the remaining taxes of $14 million owed on the $45 million, the public company's net income is the $31 million that is reported on our income statement. The total income tax expense of $21 million consists of this $14 million, plus the $7 million paid by the operating companies.

Turning to the balance sheet. It remains highly liquid with low leverage. 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. We're extremely well-capitalized from a regulatory standpoint and continue to deploy our equity capital in the growing brokerage business.

We elect to hold excess capital to take advantage of opportunities, as well as to convey the strength and depth of our balance sheet. We continue to carry no long-term debt, and our consolidated equity capital at September 30, 2017, was $6.3 billion, of which approximately $4.6 billion was held in brokerage, $1.4 billion in Market Making and the remainder in the Corporate segment.

As we stated last quarter, with the closing of the bulk of our Market Making business, we are preparing to redeploy this capital to our brokerage business, and this will bolster the broker's financial credibility and take advantage of greater customer financing opportunities.

Reviewing the segments. In Electronic Brokerage this quarter, we saw a rise in stock volume, largely driven by trading in low-priced U.S. and Hong Kong shares versus the prior year quarter, a trend that first manifested itself in the first quarter of this year.

Customer trade volumes were higher across all product types, 17% in options, 4% in futures and 50% in stocks. Foreign exchange dollar volume was up 4% from the year-ago quarter.

Commission revenue rose 13% on a product mix that featured smaller average trade sizes in options and futures and substantially larger in stocks. This mix resulted in an overall average cleared commission per DART of $3.96 for the quarter, up 1% from the year-ago quarter and down 1% sequentially.

Customer equity grew to $115.7 billion, up 40% from last year and 10% sequentially. The source of this growth continues to be a strong inflow of new accounts and customer assets across a variety of customer types. We continue to have success in attracting increasingly larger customers, including hedge funds as well as financial advisers and introducing brokers that, while large overall, manage groups of smaller accounts.

In particular, large introducing brokers who bring their business to us on either an omnibus or fully-disclosed basis are signing up with greater frequency.

Our average equity per account rose 13% year-on-year to $254,000. And as our equity -- customer equity grows, we're able to attract the larger accounts that seek out our other revenue-generating services, including margin lending and short sale support.

Margin debits rose 39% year-over-year, reaching a record level of $25.1 billion. We have continued to see healthy customer appetite for increased borrowing, which, along with our competitive rates, contributed to the increase.

As we continue to see demand from our customers for prime financing, we will be opportunistic in using our capital to satisfy it. Our stringent risk management guidelines have led to margin balances that are well diversified and secured worldwide with readily tradable, exchange-traded securities only.

Net interest income rose to $171 million, up 31% from the third quarter of 2016. The Federal Reserve's increases in the Fed funds target rate in December, March and June, together with increased customer balances, has generated more net interest income on margin- and securities-lending as well as cash balances.

Our continued success in asset-gathering sets the stage for larger revenue contributions from interest-sensitive assets going forward.

Our net interest margin for the quarter was 1.31%, which widened from the year-ago quarter's 1.12%. The increase reflects higher margin loan interest due to larger balances as well as higher rates, plus greater income on our segregated cash, also due to higher rates despite relatively flat balances. These items were partially offset by the higher customer credit interest that we paid due both to higher rates and to larger customer credit balances.

We've been -- we have recently begun several initiatives, which we spoke about briefly in our second quarter call. In order to prudently maximize our interest income, benefits from these programs will be seen in future quarters. We have set up a multibank FDIC sweep program and have just begun to take customers on. We're also expanding our segregated cash investing into more government-backed instruments, which is expected to enhance our investment yield on funds while maintaining safety and security.

As these programs are just beginning, we have no concrete numbers yet, but they are expected to be additive to our net interest income.

Based on current balances, we estimate that a single rise in overnight interest rates of 25 basis points would produce an additional $12 million in net interest income over the immediately following 4 quarters and also as a yearly run rate.

As we've mentioned previously, further increases in rates may have a smaller impact because the interest we pay on the cash in our customers' accounts is pegged to the Fed funds rate, less a narrow spread.

Please note that as we disclosed in our second quarter 10-Q filing, our interest rate sensitivity estimate has been updated to separate assumptions for U.S. dollar rates from other currencies' rates, and to isolate the effects of a rate increase on reinvestments.

Execution and clearing expenses were $55 million, up 20% year-over-year. We've received a clearing fee rebate this quarter that last year was received in the second quarter. And without this rebate, execution and clearing expenses would have been up 23%. Higher options and futures volume led to higher expenses in this area, as the exchanges charge more to trade these products than they do for stocks.

Fixed expenses in brokerage were $87 million, up 13% over the year-ago quarter. A primary component of this increase was the cost of migrating software developers from Market Making to brokerage in line with our earlier estimates.

Customer bad debt expense was immaterial this quarter. Our Risk Committee continuously enhances our scenario-based risk models in order to reduce exposures to world events.

Pretax income from Electronic Brokerage was $225 million, up 39% from the prior year quarter. Reported pretax margin was 61%, and adjusting for Treasury marks, the core pretax income was $224 million, up 27% from last year for a 61% pretax margin.

Turning to Market Making. We closed on the sale of the majority of our U.S.-options Market Making business to Two Sigma Securities on September 29th. We first announced our intention to wind down or sell in March, and began to pull back in this area after that time, and our results reflect this. The continuing low level of market maker activity reflects certain ongoing foreign operations, which may continue for some time.

We recorded a net gain of about $10 million, made up of the recapture of costs we incurred during the transition of this business to Two Sigma Securities, less a small amount in severance costs.

As of the end of the third quarter, we have wound down nearly all of our U.S. and the majority of our non-U.S.-options Market Making business.

We have the opportunity for future income from an earn-out agreement based on how well the options Market Making business performs under Two Sigma Securities' control. Under the agreement, we would earn a share of any U.S. profits after variable costs and agreed-upon other costs, for 3 years and a separate share of any non-U.S. profits, after variable costs, for 4 years.

At the closing, the majority of our U.S. business was transferred. The agreement with Two Sigma Securities provides them the opportunity to enter non-U.S. parts of this business. And while it does not preclude us from participating in these markets, the earn-out would be effective only in markets where we did not compete.

The last piece of our Market Making business, facilitating customer orders in securities like CFDs and ETFs, will continue to operate. As we've said in the past, this is a small business that provides value to our customers. However, it would be too small to report as a separate segment once the international operations are wound down, and we expect to cease reporting segments once accounting and regulatory reporting standards dictate that we stop.

For the third quarter versus the year-ago quarter, Market Making trade volume was curtailed across all product types.

Trading gains for Market Making for the third quarter were $11 million, down from $38 million in the year-ago quarter, and pretax income was $11 million in the quarter, up from pretax income of $7 million in the year-ago quarter. This includes the approximately $10 million net cost recapture I described earlier, so essentially, Market Making ran at about breakeven for the quarter.

On the cost side, execution and clearing fees expenses were down 65% on lower trading volumes, and fixed expenses declined to $13 million, down 32% from the year-ago quarter. But adjusting for about $1 million in one-time compensation charges, fixed expenses were $12 million.

A few more words on the market maker wind-down. That we recognized this additional $1 million in compensation expense due to onetime severance costs for this quarter, we expect a somewhat smaller figure for the fourth quarter, and this will keep us on track for the $25 million in onetime expenses we estimated for you earlier this year related to the shutting down of that business. We expect the current wind-down in the U.S. to be complete before the end of the year, and that continuing certain Market Making operations outside the U.S. for some period of time may significantly defray these onetime costs we have recognized. We expect our brokerage operations to absorb approximately $40 million of expenses annually going forward, slightly higher than our previous $39 million estimate, or about $0.07 per share in earnings per share.

The added costs consist primarily of personnel and certain technology infrastructure. As we have said, we expect our brokerage business to benefit from the additional software development resources, and the personnel transfers will contribute to a slowdown in outside hiring as we are seeing in our headcount numbers, for some period of time.

For the third quarter, about $3.5 million in employee compensation expenses were absorbed in brokerage, in addition to the $2 million in the second quarter. And on a full year run rate basis, the brokerage business has now absorbed about 50% of that $40 million annual amount, and we expect the migration of these expenses to continue over the coming quarters until the full amount is absorbed.

Finally, in the Corporate segment, the earnings reported reflect the effect of our currency diversification strategy. Our overall equity as measured in U.S. dollars increased by the weakening in the U.S. dollar against most other major currencies. We estimate the overall gain from our strategy of carrying our equity in proportion to the GLOBAL to be about $32 million for the third quarter of 2017. And in the income statement, $6 million of the GLOBAL gain is reported as Other Comprehensive Income, leaving a gain of $26 million to be included in reported earnings.

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

Question-and-Answer Session

Operator

(Operator Instructions) Our first question comes from Conor Fitzgerald of Goldman Sachs.

Conor Fitzgerald

First, just thanks for putting the NIM disclosure in the earnings release, it's very helpful. And then I just had 2 quick cleanup questions. Where did the recovery of the exit costs run through? And did I catch you correctly saying that ex the clearing rebate, execution and clearing would have been up 23% year-over-year?

Paul Brody

Yes, that 23% is right, and the cost recovery is recorded in other income.

Conor Fitzgerald

Got it. And then I know it's early innings, so it's a little tough to provide details on what buying other government-backed securities could mean. But from maybe a yield uplift, could you talk about the yield you're getting on the securities you think you'll be buying and then maybe some of the margin uplift you could see from this?

Paul Brody

We don't have many details yet, we just know that the class of securities that we're looking at, while being government-backed, tend to yield somewhat higher than regular Treasuries. And we're developing our investment guidelines now to figure out what portion of the overall investment we would devote to that class.

Conor Fitzgerald

Got it. And then just wanted to revisit how to think about kind of expenses on the go-forward. I think you still got something like $9 million of expenses coming out of the market maker, just backing into it, you talked about $10 million sticking around. So is $150-ish a decent way to think about the expense base going forward?

Paul Brody

So you mean the quarterly? Sorry? A quarterly total expense base?

Conor Fitzgerald

Yes.

Paul Brody

It will be, on a run rate basis, probably a little bit higher than that because when I describe that 50% of our expected annual, that's a run rate basis. In other words, at the end of the quarter, we had transferred enough personnel resources, such that on a go-forward basis, we have now captured about 50% of that $40 million. But the results for the quarter, the third quarter, it was not an entire quarter's worth of that expense, right? So it will be a little higher than your estimate, but not much.

Conor Fitzgerald

Got it. And I guess the other thing to keep in mind is execution and clearing should pick back up without the rebate.

Paul Brody

In other words, it will return to its normal rate. Yes, that's correct.

Operator

And our next question comes from Rich Repetto of Sandler O'Neill.

Richard Repetto

So I guess the first, you confused me a little bit. You said you had half the run rate in, but, okay, what portion of, I guess, isn't -- of that half isn't in? Could you sort of give us a little estimate of that?

Paul Brody

Think of it this way. We estimated the run rate of $40 million a year to be absorbed into our brokerage business, so call that $10 million a quarter. Out of that $10 million, we absorbed, because we had just started the process, about $2 million in the second quarter and about $3.5 million in the third quarter. But I want -- in order to clarify it from your point of view, we are expecting an additional $10 million a quarter once we're at full run rate. We're just not there yet.

Richard Repetto

Okay. Because like you said 2 -- about $2 million in the second quarter, $3 million in the third. So that would imply you got $5 million out -- or $20 million, but you really didn't realize that in the third quarter, I guess, is what you were saying, only a portion of the $3 million. Is that fair to say?

Paul Brody

The $3.5 million was the actual number absorbed in the third quarter. Had we moved all resources over to brokerage that we expect to, that number would have been $10 million for the third quarter. But we're in the process of migrating resources and so they haven't been fully absorbed, the $3.5 million instead of the eventual $10 million.

Richard Repetto

Okay. I guess the next question is when would you expect to move the capital from the market maker to the broker? You sort of left that a little bit open.

Paul Brody

Right. So we're looking at all of the optimal ways to redeploy that capital. It will be opportunistic. Whether we move between legal entities or set up financing arrangements, has not been finally determined yet, and there might be a mix of those things. But the capital, as it frees up, will become available whether or not it moves across legal entities. And ultimately, we'll cease to report segments and it will all be in one company's report.

Richard Repetto

Okay. Okay. And then lastly, for Thomas, a little bit about the sort of the options, the retail options business. Can you give us an update on Scottrade because the deal closed and I'm not sure how aggressively they're trying to move or bring clients back? But could you give us an update on that? And then also, the payment for order flow. What I understand -- you didn't -- you don't pay -- there is no payment for order flow, but there is some passed-on exchange -- there's still some rebates there. Could you explain that one, just remind us of why that is?

Thomas Peterffy

Okay. So as you know, exchanges pay for limit orders, right? And so some of those limit -- some of those payments we share with our customers, and I think we share all of it with our customers. So that's what -- that's where it comes from, it's not a lot of money. So in other words, it's exchange payment for order flow. Now on the Scottrade question, we haven't really -- I think what I heard is that they want to get the accounts back by the end of the first quarter of 2018, but I wouldn't swear to it, but that's what I remember. And obviously, these are their accounts and they can pull it back whenever they like. And if the customers don't want to go, they don't want to go. We will not interfere with this situation in any way. So it's between Scottrade and their customers -- I mean, sorry, Ameritrade and the Scottrade customers, right.

Richard Repetto

Right. Okay. And that's helpful. In other words, you've not seen any movement here yet?

Thomas Peterffy

No. So far, we haven't seen any, no. And again, it's not lots of accounts. It's somewhere around 2,000 accounts, I think.

Richard Repetto

And -- but it would be their more active option customers, I would assume?

Thomas Peterffy

No, I'll tell you frankly, I haven't looked up this currently. I don't know how active they are. They certainly are not as active as original Interactive Brokers customers.

Operator

And our next question comes from Mac Sykes of Gabelli.

Mac Sykes

With respect to the market maker divestiture, how much impact has that had on recent client acquisition?

Thomas Peterffy

That did not have any impact on client acquisition. I don't see why you would connect the 2 things. Oh, you mean because we can freely say that we don't have this conflict anymore, that's what you're referring to. Well, it's very hard to say. And besides, it's only started. It's only been the last 2 weeks, right? So we don't know of anyone who specifically came and said, now that you no longer have a conflict, we will transfer our account to you, but I would think that, that does happen in people's minds, especially in hedge funds.

Mac Sykes

Understood. And when I think of IBG, I think of technology innovation, a broad suite of global product vehicles and as you mentioned, sophisticated traders. And love it or hate it at this point, Bitcoin's market cap is now about 1/3 of JPMorgan's. So 2 questions on this. Have you considered accessing this marketplace? And number two, have you heard client feedback asking for this kind of access?

Thomas Peterffy

The answer is yes to both, and the result is that we're not going to do it.

Mac Sykes

Got it. What would make you just change your mind?

Thomas Peterffy

If the United States of America said, you know, besides dollars, we also have Bitcoins, and you can pay your taxes in Bitcoins, we would be the first one to go and do it.

Operator

And our next question comes from Chris Harris of Wells Fargo.

Christopher Harris

Can you help us understand how the bank sweep program is going to work conceptually, and then I'm just also wanting to know what the economics behind that program might be?

Paul Brody

Sure. So basically, it's structured to help clients with -- larger clients with funds that exceed the SIPC insurance limit, with -- which is $250,000 in cash per brokerage account. We're offering it up to $2.5 million in additional coverage on top of that, that would be FDIC coverage because their funds would be swept to FDIC-covered banks, not unlike other brokers who offer the program, but the primary difference is that we are offering our same high interest rates on that product. What you see the other brokers offer are fairly dismal rates on FDIC sweeps. So they're gaining FDIC insurance but they're not sacrificing anything in rate by signing up for our program. And then the rate that we will receive will be higher than our average investment rates, so we will simply benefit by a larger spread. It's too early on to -- I mean, we've done some modeling, but it's too early on to know how big the program will be in its entirety, and it will certainly grow over time. And -- but it's literally just rolled out, so we don't have any hard data yet.

Christopher Harris

Okay. Understood. And with respect to your yield on, say, cash, nice increase. I guess some of that should be -- not a surprise, clearly. But as we think about the setup going forward, I mean, excluding the initiatives you guys are working on, is there any reason to believe that, that yield will continue to rise absent what the Fed may do?

Thomas Peterffy

You mean the yield that we receive will rise absent what the Fed will do? Yes, but -- and aside of this program you mean? Yes, we still have a little bit of Treasuries we bought some time ago. So as that gets reinvested, yes, that will rise, but not by a substantial amount. It's single basis points, single-digit basis points.

Christopher Harris

Okay. Great. Then really quick, last question. On the account growth, obviously, the introducing brokerage just continues to do well there. When you guys kind of market the company and you think about how big the backlog could be there, I guess, I'm trying to size up how large that opportunity can really be for Interactive. I mean, it's just tough for us to size it. I was just wondering if you had any thoughts...

Thomas Peterffy

500 million accounts. It'd be 500 million accounts.

Christopher Harris

And how do you get that number?

Thomas Peterffy

There are 7.3 billion people. How many brokerage accounts are there in the world? And there are more and then they are growing very rapidly because in many developing countries, there are barely any so far, but they are coming very rapidly. Now, of course, we will have competitors, who will try, who will do their best to not let us have them all.

Operator

And our next question comes from Kyle Voigt of KBW.

Kyle Voigt

I just had a few follow-ups. Just one more question on the expense front. So the $87 million of fixed expenses in the e-broker, Paul, I know you said $3.5 million of the run rate from the market maker's already come over, so that implies there's another $6.5 million left to be migrated into the e-broker. But then the expenses in the market maker, that just goes away. So the $19 million, you're only going to see $6.5 million come over, and then it's going to be -- the rest of that will be eliminated. Is that the right way to think about it?

Paul Brody

Yes, the $19 million also includes variable. And this quarter was $6 million of execution and clearing. So if you -- the fixed portion of that, I'd say $13 million. And yes, that will go away.

Kyle Voigt

That's really helpful. And then just one follow-up on the FDIC program. Just wondering, I know -- and it's a stretch, but maybe I just thought I'd try. But the eligible credit balances now that you have for the program, I know there are specific requirements that you post on the website. So I know you said you did some internal modeling. I'm not sure what percentage of your credit balances you think might be even eligible, not necessarily those that you think are going to come over, but those would be eligible.

Paul Brody

We prefer not to give any specific numbers now, primarily because it's so early on and we have to see what the uptake is. We'd be probably happy to talk about it as the number's actually materialize, and we'll be -- we'll be reporting as part of our net interest income.

Kyle Voigt

And this is going to be a program that your clients need to elect into, correct? So it's not going to be like an automatic selection for someone that opens an account over a certain size.

Paul Brody

Yes, they do need to elect in. Right, I mean, from our point of view, while we don't know the takeup rate, there's no reason not to elect in, because we're paying the same good interest rate and they're getting additional coverage. So we would expect the uptake to be pretty good.

Kyle Voigt

And the rates you're getting on the bank sweep program right now, it's just, I'm assuming, it's a bit above Fed funds, so you're at -- your, say, cash, I guess, is earning 109 bps, so it would be above that. Is that the right way to think about it?

Paul Brody

It's above that, yes. They're pegged to Fed funds plus.

Kyle Voigt

Okay. And then, sorry, one more -- I guess on the IB debit card feature that rolled out in the quarter, I guess is the strategy here really just to try to grow your share of wallet from existing customers, so potentially having them migrate more of their savings or investment-type cash into IB accounts? And then just wondering if you could kind of give any indication onto the early response you've seen from the client base?

Thomas Peterffy

Absolutely. So we hope that existing accounts will do more and more of their banking with us, since we pay a higher yield on cash than the banks do. If -- unless they want to invest their money for some term, they are better off having the money with us. Obviously, it's also very convenient to not have to worry about overdrawing your account; when they use our card for purchases when they basically run out of cash. The uptake so far has been favorable, but we're very early into the process. And we do hope that eventually, not only our customers will use the card but also the card itself, the availability of the card, will bring us additional customers. So people who have margin accounts at other brokers will be more likely to consider us. Our salespeople have come back from time to time saying that certain investment advisers will come to us if we allowed them to have a payment feature on the account.

Operator

And our next question comes from Doug Mewhirter of SunTrust.

Doug Mewhirter

Most of my questions have been answered. I just wanted to go back to the Market Making operation. It sounds like you've essentially closed the deal with Two Sigma. And would you be putting that -- those revenues into discontinued operations in the fourth quarter? Or do they run off -- or I'm just trying to know how it's going to be structured. I heard that you are no longer going to report segments, but I was just wondering how the -- you're going to account for the operations that you've sold to Two Sigma.

Paul Brody

So the most likely thing to happen is that since we are continuing some of the smaller non-U.S. operations, it will be continued to be reported as a segment until those actually wind down, which will probably occur next year at some point. So expect continued segment reporting. At some point, when the GAAP and SEC reporting guidelines take over, and I think that happens when it's fully shut down, then there's some reporting as discontinued operations, yes. That's a relatively technical matter.

Doug Mewhirter

Okay. And just going back to the debit card, one technical question. To the extent that they can -- they can use it to sort of borrow against their account, which I'm assuming that, that is one of the key functionality points, what -- are you -- do you charge them whatever margin interest rate is? Or is it margin plus something?

Thomas Peterffy

No, it's the margin interest rate. So that is why we can say that the highest you ever pay is 2.66% and the lowest is 1.41% because those are our margin rates up until the Fed raises, are within these 2 numbers. So that's why the card is so incredibly attractive to people who spend more than the cash they had.

Operator

And our next question comes from Chris Allen of Rosenblatt.

Chris Allen

I just wanted to circle back real quick on execution and clearing. The 23% year-over-year increase applies to $76 million execution and clearing fees. There was a $15 million rebate, is that what you're saying? And does that rebate occur every year? It sounds like it does. I just wanted to clarify that going forward.

Paul Brody

So I'm not exactly sure what numbers you're quoting. Execution and clearing was $61 million for the quarter, and that had several million of rebate and it was not a great big number.

Chris Allen

Got it. Okay. I was curious about the 23% increase you talked about. Was that -- so all it did was take 23% over the $62 million from last year?

Paul Brody

So in my remarks, I was referring to the brokerage side. And the portion of execution was $55 million, and that was up 20% and that would have been up 23% if we had not booked a rebate. I just want to be clear on -- because we know that there's a focus on run rate, and therefore we wanted to disclose that.

Operator

And I am not showing any further questions at this time. I would now like to turn the call back over to Nancy Stuebe for any closing remarks.

Nancy Stuebe

Thank you, everyone, for participating today. And as a reminder, this call will be available for replay on our website, and we will be posting a clean version of our transcript on the site tomorrow. Thank you again, and we'll talk to you next quarter-end.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program, and you may all disconnect. Everyone, have a wonderful day.