

# **Interactive Brokers Group's (IBKR)**

## **Q3 2018 Results - Earnings Call Transcript**

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### **Executives**

**Thomas Peterffy - Chairman and CEO**

**Paul J. Brody - CFO**

**Nancy E. Stuebe - Director, IR**

### **Analysts**

**Chris Harris** *Wells Fargo Securities*

**Mac Sykes**, *G. Research*

**Kyle Voigt** *Keefe, Bruyette, & Woods*

**Brian Pirie**, *Reade Street Capital*

**Rich Repetto** *Sandler O'Neill*

### **Operator**

Good day, ladies and gentlemen, and welcome to the Interactive Brokers Group Third Quarter Financial Results Conference Call. (Operator Instructions) As a reminder, today's program may be recorded.

And now, I'd like to introduce your host for today's program, Nancy Stuebe, Director of Investor Relations for Interactive Brokers. Please go ahead.

### **Nancy Stuebe**

Good afternoon, everyone. Thank you for joining us to review our 2018 third quarter performance. Once again, Thomas is on the call, but asked me to present his comments on the business, he will handle the Q&A.

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.

This quarter saw several new developments at Interactive Brokers. I will start with our decision to move our primary listing to the IEX Exchange.

I want to emphasize that our stock continues to trade at all the exchanges it did before. But by moving our primary listing to IEX, we believe investors buying or selling our shares will get better prices. Typically, executions on the IEX are done at the midpoint of the bid-ask spread, which is better than where they are done on other exchanges. This is because IEX has a discretionary midpoint peg order that allows traders to post limit orders at the midpoint, and give the exchange the discretion to cancel the order for 3 milliseconds at the time when limit orders at other exchanges are crumbling, and then reinstate the order at the new midpoint. So it is the combination of the exchanges' speed bump with their Crumbling Order software routine that makes this an effective order type, where the limit order gets picked off much less often.

Anyone interested should go to the IEX website and read up on this facility.

IEX' signature feature, a speedbump of a few milliseconds, is better for investors because high-frequency traders, the traders who buy retail order flow from other brokers cannot take advantage of the order. When there are middlemen involved, as they are another mouth to feed, costs are raised, not reduced. It is our goal to make sure the cost to invest is as low as possible, and then to give that benefit to the investor. We do not want that benefit to go to the middlemen, who buy order flow and then trade against it.

We are pleased to be the first company to list on IEX, and we expect many more companies to follow us.

Once again, in this quarter, we set new records in our brokerage business. Our customer equity reached \$142.5 billion, up 23%; while we also hit an all-time high in customer accounts, up 26% to 576,000. Margin lending at \$30.7 billion outstanding was up 22% from the year-ago quarter and was also up sequentially.

This growth led to a net revenue increase of 21% in our brokerage business, with its pretax margin reaching 66% for the quarter.

DARTs this quarter were 763,000, up 10% over last year, though they were down from the more active first and second quarters. Market volatility, as measured by the VIX, slowed to an average of 13 in September and was coming down steadily from its 2018 monthly average high of 22 in February. Since quarter end, the VIX has risen again. Our DARTs increase comes from our consistent account growth and not from making acquisitions.

We expanded the range of financial services we offer to our customers this quarter. Through our Integrated Investment Management program, we support many different types of transactions from one account. First, our clients earn the best interest rates on their available cash - currently 1.68% on U.S. dollars in qualified accounts - without having to transfer from one account to another. Given that many banks and brokers pay only a small fraction of 1%, we see this as a huge opportunity to bring in new customers and new deposits, and we keep pushing this message in our advertising.

Customers can now also deposit their paycheck directly into their IBKR account and immediately start to earn those high rates, and use our newly introduced Bill Pay function to pay bill. Our Debit Mastercard allows our customers to pay expenses or make purchases, or they can borrow against their account at our industry-low interest rates. And they can do all this, as well as invest in securities in over 120 market centers worldwide at low cost, seamlessly from one account.

The greener grass syndrome is spreading through the industry. JPMorgan is offering free trades by selling their customers' orders to high-frequency traders, while we are offering high rates on deposits. Who's got more to gain or lose?

I like our position.

We'll have more to say about 0 commissions in our coming advertisements.

I am asked, many times, how it is that we continue to grow at such high rates and when will it stop? The answer is, it will continue as long as we adhere to our commitment to focus on building automation. This enables us to continue to compete on price, to offer ever-broader account capabilities and geographies, low commissions and low interest rates on margin borrowing, high interest rates on cash and best price execution on trades. Individually and collectively, these capabilities attract prospective clients and contribute to the growth of our business.

Further, many of the market segments we operate in are large, global and growing. Potential customers are well aware of the importance of keeping costs down and revenues up, especially in an environment where there is downward pressure on fees. So the prices we charge versus our competitors and the interest we pay on cash balances, along with the international access and technology we offer, are important points of differentiation that we talk to many potential customers about worldwide.

To reach them, we advertise in business media and in locations that reach the select customers we target, as well as on social media. We also have 40 experienced salespeople who are well-versed in our products, a team that we grew over decades. It takes more than a year to train someone who is experienced in the field in all that our platform can do, across multiple customer types in multiple countries, which have different demands and requirements.

Our salespeople are located around the world, they do everything from attending conferences and industry events to keeping track of new asset managers launching, to maintaining contact with both existing firms who may be looking to make a change, and with existing clients who recommend us to friends and colleagues. About half of our business comes from word of mouth, so the bigger we grow and the more people that are on our platform, the more people there are who talk about us and what we can do for a trader or investor.

Pretax profit for the quarter was \$276 million. Adding back the \$23 million for this quarter's unfavorable currency impact net of Treasury mark gains, gives us \$299 million or 65% pretax margin. Brokerage was \$291 million of this and achieved a 66% pretax margin.

Now for the breakdown by customer of how our brokerage business is evolving. Once again, in all our customer segments, we saw strong growth in accounts, client equity and commissions.

For the third quarter, hedge funds and proprietary trading firms were 4% of our accounts, up 11%; 19% of our client equity, up 12%; and 25% of our commissions, up 16%. Our low-margin rates and high-cash interest continue to attract institutions in a competitive space which is highly focused on execution price and overall cost. Growth in this area was strong in both developed and developing geographic markets.

Individual customers made up 49% of accounts, up 19%; 35% of customer equity, up 22%; and 50% of commissions, up 18%. Customer equity was driven by double-digit strength in all geographic regions, particularly in developed markets internationally, as word of mouth about our platform has spread. While market volatility was down sequentially, commissions benefited from higher volatility in account growth versus last year's third quarter.

Investors continue to become more aware of the practice of brokers selling their customers' orders to high-frequency traders, which is now part of a class action suit. This is a practice that gives investors lower prices on their sell orders and forces them to pay higher prices on their buys, and is something we at Interactive Brokers do not do with our customers' orders. We also see individual who want global access and low cost, not only on commissions and margin financing, but also on FX as they trade internationally, which all plays to our strengths.

Registered investment advisers represent 17% of our accounts, which is up 16%; 24% of our customer equity, up 24%; and 17% of our commissions, up 16%. The RIA segment is benefiting from our new products, our easy-to-use account mass-upload capability, low commission rates and high interest on cash balances, as well as the important facts that we do not charge an RIA multiple fees to allocate a trade among multiple customer accounts. We also offer free Customer Relationship Management, or CRM, software, as well as reporting tools that mean an RIA does not have to pay for third-party services. In an environment with downward pressure on fees, our ability to save an adviser money, while providing excellent performance, reporting and functionality, has grown increasingly important.

Finally, introducing brokers represent 31% of our customer accounts, up 48%; 21% of our

customer equity, up 36%; and 9% of our commission income, up 37%. As we discussed last quarter, our introducing brokers segment continues to benefit from the tailwind of two major trends: the increasing regulatory burden worldwide, which makes outsourcing your back office the best solution; and the growth of a new investor class in developing countries, many of whom want to trade internationally.

This quarter, we introduced our Integrated Investment Management program, which consolidates the variety of financial transactions you can do from a single Interactive Brokers account.

Without having to transfer funds between accounts, customers automatically get the best interest rates on both their cash, earning market rate interest on idle balances, and on their securities, earning extra income by lending out their fully paid shares. Integrated Investment Management also includes their Debit Mastercard, our new Bill Pay function and Payroll Direct Deposit, giving our customers more reasons to stay on our platform to transact their financial business.

Our Insured Bank Deposit Sweep Program, which offers customers up to \$2.75 million in SIPC and FDIC-insured deposits, continues to grow and reached \$1.6 billion this quarter.

Finally, we are looking forward to announcing access to Israel on our platform in the fourth quarter.

And now, Paul Brody will take you through the numbers. Paul?

**Paul Brody**

Thank you, Nancy. Welcome, everyone, to the call, thank you for dialing in. I'm going to review our results as usual, and then we'll go onto some detail on the drivers behind the numbers and then we'll take questions.

Let me begin by highlighting that our headline numbers for net revenues and pretax income imply a 3% year-over-year increase for both of those measures. But when we remove the effects of noncore operating items, primarily from our currency diversification strategy and the sale of our U.S. Market Making business in 2017, those numbers rise to 19% and 29% respectively, and I'll give more detail on this in my review of the financials.

So let's turn first to the operating metrics, which reflected strong growth in customer accounts, equity and cash balances, while trading volume were generally in line with market volatility. The volatility as measured by the average VIX, rose to 12.9 this quarter, up 18% from 11 in last year's third quarter. Sequentially, however, this quarter's average VIX declined from 15.4 in the second quarter, and from 17.2 in the first quarter after our particularly volatile February and March. The increased volatility over the year-ago quarter led to an 8% rise in options trading volume, while futures and stock volumes were off 4% and 20%, respectively.

The decline in stock trade volumes was due to lighter trading in low-priced stocks, and an increase in the proportion of trading in higher priced stocks as a result of this shift, while the number of shares traded declined, as the DARTs and the commissions on stocks both rose. Finally, foreign exchange volume was down as well.

Total accounts grew to 576,000, up 26%, which contributed to customer equity growth of 23% to \$142.5 billion. We saw growth in all customer segments, particularly in introducing brokers and financial advisers. With the continued tailwind from new account growth, our quarterly total DARTs were up 10% versus last year, our overall average cleared commission per DART fell 5% year-on-year to \$3.78, on a product mix that featured smaller average trade sizes in stocks, options and forex, and slightly higher in futures.

Moving on to net interest margin table. Our net interest margin widened to 1.68% from 1.31% in the third quarter last year. The Federal Reserve raised rates again this quarter in late September, making a total of 4 increases in the Fed funds target rate since December 2017. Due to careful management of our short-duration portfolio, we recorded a modest mark-to-market gain of about \$1 million on our holdings of U.S. Treasuries. As always, we plan to hold these securities to maturity but as brokers, unlike banks, GAAP rules require us to mark them to market in our financial reporting.

U.S. rate increases, together with increased customer balances, generated more net interest income on cash balances. We believe our continued success in asset gathering should lead to larger contributions from interest-sensitive assets going forward. Our FDIC Insured Bank Deposit Sweep program, introduced late last year, continues to grow and reached \$1.6 billion.

Margin lending and segregated cash management were the most significant contributors to our net interest margin. Average margin loan balances grew 22% versus last year, which combined with higher interest rates, led to margin interest growth of 72%. Our segregated cash interest income rose 52%, primarily on Fed hikes to U.S. interest rates.

Two factors caused the yields on our segregated cash to not precisely match the increases in Fed funds rate: first, currently about 15% is held in other currencies, although recently, 11% of that is held in currencies that also showed various elevated interest rates during the quarter; and second, given the current average duration of investment in Treasuries is slightly under 90 days, and given that about 18% of the portfolio does not pick up a new yield until the subsequent quarter, these amounts would not be expected to follow a Fed hike immediately.

The year-over-year decline in segregated cash balances is a function of increase in margin loans, of cash swept to our FDIC Sweep program, and of more customer cash being put to work in the securities markets. Starting with the month of September, we began to break out in our metrics the FDIC Sweep program, now \$1.6 billion which, for accounting purposes, removed funds that would otherwise be included in our segregated cash balances on our balance sheet.

Securities lending interest income was lower this quarter as there were fewer of the highest rate hard-to-borrow lending opportunities in the market than in prior periods.

Now for our estimate of the impact of the next 25 basis point increase in rates. With the continued growth in our customer assets, the investment opportunities available to us, and new product introductions, we are well positioned to maximize our net interest income. Expectations of further rate increases are typically already reflected in the yields of the instruments in which we invest. Therefore, in our calculation, we tend to isolate the impact of an unexpected rise in rates, separate from the impact of rate hikes that have already been baked into the prices of these instruments. With that assumption, we would expect the next 25 basis point unanticipated rise in rates to produce an additional \$19.5 million in net interest income on customer balances over the next 4 quarters, and \$21.4 million as the yearly run-rate. That run-rate includes the reinvestment of all of our present holdings at the new, higher rate.

Turning to segments, Electronic Brokerage turned in a solid performance, with gains in both



commissions and net interest income. Net revenues were \$444 million for the quarter, up 21%. Pretax income was \$292 million, up 30%, for a 66% pretax margin. The Treasury marks at \$1 million were not material to segment results.

We received a \$3 million clearing fee rebate this quarter versus \$1.5 million in the year-ago quarter. These are accounted for as decreases in Execution & Clearing expense. Without these rebates, the Execution & Clearing expense would have been up about 1%.

Fixed expenses in brokerage were \$99 million, up 14%. The primary reason for this increase were the previously disclosed migration of expenses related to the winding down of Market Making, also to increase legal and compliance expenses and also contributions to reserves. Customer bad debt expense was a small gain this quarter, reflecting immaterial new debts and our successful efforts to collect on some debts from prior periods. This is a demonstration of the continued effectiveness of our risk management systems in limiting customer defaults.

Market Making continues to consist of customer facilitation activities and options market making in a small number of profitable markets outside the U.S., which we will operate for the time being as we continue to evaluate them. Net revenues were \$16 million, of which \$7 million were trading gains and the bulk of the remainder was net interest income. Market Making pretax income was \$7 million. We remain at about 95% absorption of the \$40 million of expenses that were projected to migrate to brokerage, and we expect to reach full absorption in the fourth quarter.

Corporate segment reflects the effect of our currency diversification strategy. We carry our equity in proportion to a basket of 14 currencies we call the GLOBAL, to best reflect the international scope of our business. As the U.S. dollar strengthened against most other major currencies this quarter, we incurred an overall loss from our strategy of \$27 million, of which \$3 million is reported as Other Comprehensive Income, or OCI, and \$24 million is included in the earnings. We estimate the total decrease in comprehensive earnings per share from these currency effects to be \$0.06, with \$0.05 reported in Other Income and \$0.01 as OCI.

Turning to the income statement. Net revenues were \$439 million, up 3% over the year-ago quarter and, adding back the \$24 million loss on our currency strategy, net of the \$1 million gain

from marking our Treasury portfolio to market, results in adjusted net revenues of \$462 million for the quarter, up 19% over last year's \$388 million, after adjusting for these items and also adjusting for an \$11 million gain on the sale of our U.S. market making business last year. Commission revenue rose 2% on higher volume and options, and as I mentioned before, higher DARTs in stocks, partially offset by lower average trade sizes in most product categories.

As we noted earlier, the decline of our overall average cleared commission per DART to \$3.78, reflected this mix. Of the \$244 million net interest income, Brokerage produced \$235 million, Market Making \$7 million, and Corporate, the remainder.

Other income, which includes our GLOBAL currency strategy, Treasury marks and other fees and income we receive, was \$21 million. Aside from the decline in the GLOBAL and the absence of last year's onetime gain on the transfer of our U.S. market making business, nearly all areas of other income showed increases.

Noninterest expenses were \$163 million for the quarter, up 3% from last year. The primary drivers were \$10 million higher general and administrative expenses, largely stemming from legal and compliance costs and reserves. As a note, the G&A expenses in the year-ago quarter contained a \$3 million recovery of a tax reserve, so the increase would have been \$7 million or 39% otherwise. The G&A increase was partially offset by lower execution and clearing expenses, aided partly by the higher clearing fee rebate mentioned earlier, as well as the discontinuation of our U.S. options market making business. Also acting to offset the increase were lower employee compensation and benefits expenses, which include regular adjustments to year-to-date budgeting for bonus accruals.

At quarter end, our total headcount stood at 1,380, up 15% from last year. We have been hiring most aggressively in the areas of client services, legal and compliance, and software development and, to this end, we continue to build up our operations in India.

Pretax income of \$276 million was up 3% and represented 63% pretax margin. Adjusted for the noncore items I mentioned previously, pretax income was \$299 million, up 29% over last year's

pretax income of \$231 million on an adjusted basis, representing an adjusted pretax margin of 65%.

Diluted earnings per share were \$0.51 for the quarter versus \$0.43 for the same period in 2017. Comprehensive diluted earnings per share, which includes all currency effects, were \$0.50 for the quarter versus \$0.44 last year. Without the impact from currencies and Treasury marks, diluted EPS would have been \$0.56, so \$0.05 higher than the reported EPS for the quarter.

To help investors better understand our earnings, the split between the public shareholders and the noncontrolling interest is as follows: first, as a preface, the reclassification of one of our foreign entities resulted in additional reported onetime income tax expense of \$4 million and partially offsetting other income of \$3 million. These entries affect the public company only and they are similar to those we reported at year-end, which were related to the Tax Act. The additional tax is a noncash item that affects our reported income only and not actual taxes paid.

So, starting with income before income taxes of \$276 million, we first deduct the \$3 million of other income related only to the public company, leaving \$273 million of operating companies income. We then deduct \$6 million for mostly foreign income taxes paid by our operating companies. That leaves \$267 million, of which 82%, or that \$219 million reported on our income statement, is attributable to noncontrolling interest. The remaining 18%, or \$48 million, is available for the public company shareholders but, as this is a non-GAAP measure, it's not reported on our income statement. After we add back that \$3 million of other income to the \$48 million, totaling \$51 million, and deduct the remaining taxes of \$12 million, public company's net income available for common stockholders is the \$39 million you see reported on our income statement. The \$12 million contains the onetime \$4 million tax expense related to the reclassification I mentioned; that is, without this item, the public company tax would have been \$8 million. Our income tax expense total of \$18 million consists of this \$12 million, plus the \$6 million of taxes paid by the operating companies.

Turning to the balance sheet, it consistently remains highly liquid with low leverage. We're extremely well-capitalized from a regulatory standpoint, and we continue to deploy our equity capital in the growing brokerage business. We hold excess capital in order to take advantage of

opportunities as well as to emphasize the strength and depth of our balance sheet, and we continue to carry no long-term debt.

At September 30, margin debits were \$30.7 billion, an increase of 22% over last year. Our compelling margin lending rates, which become increasingly noticeable versus our peers as the interest rates rise, plus our customers' willingness to take on leverage and Interactive Brokers' capacity to satisfy it, have contributed to this growth. This figure may show more swings than in past years due to our success in attracting institutional hedge fund customers, who are more opportunistic in taking on leverage. Our conservative balance sheet management supports a growing margin lending business.

Our consolidated equity capital at September 30, 2018, was \$6.9 billion. \$5.5 billion was held in brokerage, \$1.1 billion in Market Making and customer facilitation activities, and the remainder in Corporate.

Now I'd like to turn the call back over to the moderator, and we will be happy to take some questions.

## **Question-and-Answer Session**

### **Operator**

(Operator Instructions) Our first question comes from line of Rich Repetto from Sandler O'Neill.

### **Rich Repetto**

The first question is, on the growth rates, Thomas, you can still report the highest growth in the industry. But if you look back compared to last year, it has moderated somewhat from the high 30%, 40% in growth year-over-year in equity and margin loan balances, et cetera. I guess, I'm trying to see is, is that -- has the growth been -- again, still tops in the industry, but has it been slowed by, in any way, Asia, and what's going on in the Asian markets or could you attribute it -- what would you attribute it to, the change?

**Thomas Peterffy**

So last year, the growth was higher because the market went up and many of our customers were very invested. So their assets -- the value of their assets has increased. This year, up to the end of September, our customers' total profit was only about \$1.1 billion. So all the growth this year was due to new assets.

**Rich Repetto**

And then, in the past, you haven't quantified it, but you just said the fastest growing area was Asia. Is that still -- does that still hold true now?

**Thomas Peterffy**

That still holds true, yes.

**Rich Repetto**

Okay. And then the next question is on the shares per trade. We understand it's lower trading in the low-priced stocks and you made up for it nicely in proportion, people trading higher-priced stocks, with the commission. But I guess, what we're not seeing is, at least from what channel checks I've done, is other brokers being impacted in the low-price trading and low-priced stocks or have I got that wrong or...

**Thomas Peterffy**

So if you remember, it was at your conference when I asked Chairman Clayton about whether the SEC is going to issue any clarification on the low-priced stock campaign. They are basically, in so many words, telling us that we shouldn't take customers who want to bring in low-priced stocks, and when they sell it through us, unless we jump through several hoops, but they don't tell us what the hoops are. So it's -- I asked him at that time whether they plan to clarify this, and he said they are working on it, but I haven't heard anything yet. So we just tightened up on the circumstances under which we allow our customers to trade low-priced stocks.

**Operator**

Our next question comes from the line of Kyle Voigt from KBW.

**Kyle Voigt**

Just a couple of questions on margin lending first. First, just the sequential increase in the yield on customer margin, I think it was 26 basis points. I think this is the second consecutive quarter really, that it outpaced our expectations. Just wondering if you're seeing some client mix within the margin balances that's been helpful to the overall yield. I guess in other words, are a larger portion of the margin balances coming from those lower-balance and higher-priced tiers?

**Thomas Peterffy**

Yes, there wouldn't be any other explanation for that.

**Kyle Voigt**

Okay. And just a follow-up there. Early this year, you raised pricing on the upper tier margin balances by about 5 basis points. And in that press release, you set \$30 billion as sort of a threshold or benchmark that you were monitoring previously. Just curious, now that margin balances have exceeded that \$30 billion mark in September, are you comfortable with the level of customer margin that you have right now, or will you continue to make pricing adjustments?

**Thomas Peterffy**

Yes, we are comfortable because our credit balances have also risen in parallel.

**Kyle Voigt**

Okay, all right. And last one for me, is just on the -- you've launched a number of solutions over the past, really, year, 18 months, that really seem targeted at trying to increase your share of your clients' wallet through this Integrated Investment Management offering, with the debit card, and direct deposit. Just wondering, since these have been rolled out, do you think that you're having success in increasing that share of wallet and other metrics that you track internally, I guess, that would suggest that you're having success there.

**Thomas Peterffy**

Well, you know, as we say, we have roughly \$61 billion of cash, which is more than 1/3 of all of

our assets. So I wouldn't know how to ascribe it to anything else but to the high interest we're paying.

### **Operator**

Our next question comes from the line of Mac Sykes from Gabelli.

### **Mac Sykes**

I did appreciate Nancy's comments on the free trading and your initiatives there. But maybe you could talk a little bit more about this topic of free trading. It seems like some of the customer agreements from some of your competitors actually have hidden costs in them, and I just want to get your thoughts on, sort of, advertising free trading and whether that's truly the case. And then secondly, have you gotten any feedback from your customers given that you are the low-cost offering in terms of customer feedback around free trading and I don't want to say complaints or just questions around that and what you may be doing about it.

### **Thomas Peterffy**

So this is a serious issue for us now that JPMorgan has joined Robinhood, offering free trades. We have to take this very seriously as a threat. So we are currently working on a commercial to explain to people why that is bad for them. And -- but the fact is that, if you look at our ACATS, for example, we regularly gain customers, 2, 3, 4 customers a day from Robinhood, and I've never really seen a customer who went from us to Robinhood.

### **Mac Sykes**

Okay. And you talked a little bit about market reform on the small-cap stocks. But could you just talk about maybe market reform in terms of maker-taker model going forward, I mean, your partnership with IEX and where you see that maybe changing over the next 5 years or so?

### **Thomas Peterffy**

Well, we have no idea what is going to happen. I really don't know. I mean, it's hard to get anything from the SEC, any indication or any -- it's -- they must be very busy, because we are not successful in trying to talk to them about anything.

**Operator**

Our next question comes from the line of Chris Harris from Wells Fargo.

**Chris Harris**

Just wanted to follow back up on the point about industry fee cuts and pricing pressures. Are you getting inquiries from customers about JPMorgan, about Robinhood? I mean, it sounds great that nobody is transferring out. But I just wanted to know if you...

**Thomas Peterffy**

No, we have not heard. No one has asked us anything. We have a more sophisticated customer base, they understand what goes on here. So, we always tell them how much money the brokers earn in payment for order flow, and they understand where that comes from.

**Chris Harris**

Got it, okay. I mean...

**Thomas Peterffy**

We never had a call saying could you do my trades commission-free, no, that has not happened.

**Chris Harris**

Yes, okay. I mean, you clearly have a well-documented value proposition, that sounds like your customers get it, just wanted to clarify that point. Okay. Another topic, in terms of interest earning asset balances. You've got the FDIC Sweep program now, and I'm wondering if you guys have thought internally about what the opportunity for that could potentially be. I mean, how many of your customers you think might want to take advantage of that program. I know it's early days but clearly you guys get pretty nice economics there? So maybe you could elaborate on that, if you could, for us?

**Thomas Peterffy**

Paul, do you want to address that?



**Paul Brody**

Yes, sure. So we began to roll it out last -- fourth quarter of last year. And we fairly quickly made it available to the various customer groups that would be eligible for it. We haven't quite covered them all. We estimate that if we had full participation, maybe the balances would be probably a little more than double what they are. So we've got pretty good take-up on it right now. We're happy with it. Our own earnings are at, or maybe a little bit better than, our other investment rates, other investment rates with banks, without taking advantage of the yield curve, of course. So it's operating quite well. We're happy with it, at the level it's at, we think it grows steadily as customers pick up on it. And I think new customers, we made efforts to present it to them, sort of, on their way in. So there's probably more take-up there than there was before, and it's a good program.

**Operator**

Our next question comes from the line of Brian Pirie from Reade Street.

**Brian Pirie**

First question is a follow-up on Rich's remarks about trading activity in low-priced shares. I'm wondering if you could give a little more color on what types of operational changes you made to achieve the curtailment of trading in low-priced shares among your existing customers? And then, for this quarter, just approximately, what impact do you think that curtailment had on your DARTs?

**Thomas Peterffy**

So our compliance department issued new regulations, which we use internally, that strictly describes what kind of trades we can and cannot accept. What kind of orders we can accept and what kind of orders we cannot accept. The upset on the part of customers was substantial. We said we -- there's nothing that we will do about that. And if they don't like it, we are sorry, but we cannot have them. A number of them have gone to see -- to look for other brokers. And that's all I can tell you. I did not do the work to figure out how many low-priced stock trades we have lost per day, for example. Have you, Paul? You had some...

**Paul Brody**

I don't have detail at that level, no.

**Brian Pirie**

Got it. I mean, the reason I was asking was, volatility was up almost 18% year-over-year and your account growth is in the mid-20s with DARTs growth of just about 10%. I'm wondering if there's any way to -- it's in effect that you'll probably lap in a year, I'm guessing. And so, I'm interested in any way to ballpark that effect that you'll presumably lap in, I don't know, 9 months or something?

**Thomas Peterffy**

Well, no, I'm sorry, I do not think that -- I think a greater impact is what is coming from the fact that more of our new accounts are introducing broker accounts, and those accounts tend to trade less than our original customer base, which is the sophisticated traders. When we started the business, we originally addressed ourselves to floor traders. People who were trading for a living, right? So that's why we still have -- our basic customer is still that, that's where the bulk of our volumes come from, but those people are getting old, as I know.

**Brian Pirie**

Yes. And second question, if I could. So customer credits represented about 36% of customer equity in this quarter, and that's inclusive of sweeps. I'm wondering how different that number looks for your new customers, for incoming assets.

**Paul Brody**

I don't think we measure it separately for the incoming customers. But you have to understand, and perhaps not put too much weight on the credit number itself because, as I mentioned before in my talk, that we've got a very steady stream of customer money and asset transfers coming in all the time. But the credit balances are subject to what happens to them after that. So they become invested depending on what the market is doing, the customers actually become more or less invested in stocks, that's one primary factor. Certainly, on an aggregate basis for us as a

broker, we take customer credits and lend it to other customers who are doing secured margin lending, and that has certainly gone up quite rapidly. So that leaves us with less to invest on the Street, but customer credits are still going up. So all of these factors contribute to -- obviously, they all work their way into the net interest margin in one way or another. But you have to understand about the customers being invested in the market, which is certainly not under our control.

**Brian Pirie**

Got it. And it sounds like it's not a number you track or have the ability to track, it's just the point you made. It's a really important input in projecting what net interest income will grow at over the longer term, it's just how intense new clients are in terms of their cash balances.

**Thomas Peterffy**

Yes. But you have to remember that these clients -- at least the ones that have more than \$100,000 dollars' worth of assets with us are getting paid interest. And so what we earn on these balances is half a percent.

**Brian Pirie**

Yes. I mean, it adds up. It's more -- it's like larger than your commission revenue now.

**Thomas Peterffy**

Right. Yes, sure, sure, sure.

**Operator**

(Operator Instructions) Our next question is a follow-up from the line of Mac Sykes from Gabelli.

**Mac Sykes**

I wanted to just dig into -- if I were to have, say, \$100,000 account at the firm, fully invested in S&P securities. How much I would hope to make just on the collateral that could be used from the portfolio.

**Paul Brody**

So it's interesting that you picked S&P securities because those tend to be, what we would call, "general collateral", meaning blue chips and fairly uninteresting from a lending standpoint as far as the demand on The Street. If you had picked another index that had more what we call hard-to-borrow stocks, more esoteric names, more stocks in greater demand, you could certainly see substantial earnings from participating in the fully paid lending program. And those numbers are all over the lot and they come and go. That's why the securities lending revenue is very much a function of which stocks get hot at certain times. We've seen Tesla come and go, sort of, in terms of its demand for shares on the Street, that's just one name. And our job is -- we have built tools to take advantage and optimize the lending when these stocks go into a range where their rates get very high.

**Mac Sykes**

And just to clarify on GC. What's the yield, I guess, are there earnings on that?

**Thomas Peterffy**

There is no yield on GC.

**Paul Brody**

Right. We don't even lend out GC because it doesn't produce any yield. But if you were a customer, I can tell you that you can look into a report that we would deliver to you, that would tell you what the indicated earnings would be on the portfolio that you actually hold in your account, to try to interest you or see at least -- get you to see what the value of participating in the program might be. So we have very good participation in the program because we do a good job of lending shares out.

**Operator**

Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Nancy Stuebe for any further remarks.

**Nancy Stuebe**

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

**Operator**

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.