

Interactive Brokers Group's (IBKR)

Q4 2018 Results - Earnings Call Transcript

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Executives

Thomas Peterffy - Chairman and CEO

Paul Brody - CFO

Nancy Stuebe - Director, IR

Analysts

Chris Harris *Wells Fargo Securities*

Mac Sykes, *G. Research*

Kyle Voigt *Keefe, Bruyette, & Woods*

Rich Repetto, *Sandler O'Neill*

Chris Allen, *Compass Point Research*

Operator

Good day, ladies and gentlemen, and welcome to the Interactive Brokers Group Fourth Quarter Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded for replay purposes. It is now my pleasure to hand the conference over to Ms. Nancy Stuebe, Director of Investor Relations. Ma'am, you may begin.

Nancy Stuebe

Welcome, and thank you for joining us for our year-end 2018 earnings conference call. Thomas will handle the beginning of the call and the Q&A, but asked me to present the rest of his comments.

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. I would like to briefly touch on 2 items related to our recent announcements. First, as we signified in our press release in early January, as of the end of September, I will be passing the CEO title to Milan Galik, our current President. I'm not doing this because I want to retire and travel around the world and hang out in lovely hotels and beaches. I would find that boring. I absolutely love to work at Interactive Brokers, and I will continue to do that, while recognizing that due to my mature age I can best contribute by focusing on strategic and structural issues going forward.

Milan is an engineer who joined us fresh out of university and has worked with me at Interactive Brokers for 28 years. He has been on our Board since we went public in 2007. With Milan as CEO, the strength and quality of our platform will continue to grow, and he shares my goal of making Interactive Brokers the largest broker in the world. Those of you who have not met Milan at our last annual meeting will have a second chance to do so at this year's annual meeting on the 18th of April in New York City. I will remain involved, supporting Milan at the company as its chairman.

Second, there is altogether too much focus on the part of our current and would-be future shareholders about the question of what is going to happen to my shares. My answer was always that I am a firm believer in the long-term success of this company, and I'm not interested in selling in the near future.

While that is true, people did not want to believe it and their doubts were further aggravated by tax considerations upon death. For that reason, I came up with the idea that these concerns would

be resolved by my starting a selling program that would dispose of the shares gradually over the next 60 years.

This program demonstrates my long-term commitment to the company. It would also generate sufficient cash to deal with the tax issues, and will also gradually increase the public float, which will be good for the liquidity of the issue.

Accordingly, I will implement a trading program, starting after the July 2019 earnings announcement, and sell 20,000 shares on each business day. As our average daily volume is nearly 700,000 shares, these sales will have little, if any, impact. Nancy, please take it from here.

Nancy Stuebe

Thank you. Interactive Brokers once again ended the year with record numbers. Accounts were 598,000, up 24%, and client assets and quarterly DARTs were at year-end records of \$128 billion and 951,000 respectively. Brokerage pretax margin was 63%, and our total equity is now over \$7 billion. We achieved this in the face of weaker global securities market and political and economic uncertainty.

We are also very pleased that third-party information firm IHS Markit recently analyzed U.S. stock execution and determined Interactive Brokers executed orders at \$0.50 per round lot better - meaning cheaper - than the industry average. That translates to huge savings for our customers who experienced better performance by lowering their trading costs.

We achieved this improvement through our superior technology and our founding practice of never selling our customers' orders. Instead, we searched through many venues for the best available price, which is often hidden as traders do not want to reveal their buying or selling intentions. During our search, we constantly refresh accumulated statistical information about the likelihood of finding a better price for any specific stock at any specific venue.

This software has been expensive to develop and maintain, but it pays for itself in generating loyal customers, who tend to trade more often and accordingly, benefit the most from superior execution.

Fourth quarter net revenues were up 17% to \$496 million in 2018 versus \$425 million in 2017, adjusted for our usual noncore items of currency translation and Treasury portfolio marks, and especially, for last year's \$93 million in onetime income from the U.S. Tax Act. Commissions were \$205 million, up 21%, while our net interest revenue was \$243 million, up 19%.

For the full year, excluding noncore items, net revenues were \$1.9 billion, up 28%, and pretax profit was \$1.2 billion, up 38% for a pretax margin of 63%.

Our business is now virtually all electronic brokerage. In 2018, the brokerage segment surpassed \$1 billion in pretax profits for the first time, reaching nearly \$1.2 billion, up 37% and achieving a 64% pretax margin.

There is no other broker who comes close to our levels of profitability.

As a matter of fact, potential new institutional customers often ask the question, “How can you make a profit with such low prices?” And when we say automation, they often do not believe it. They think we are doing something funny. This is very frustrating, but as we have more and more satisfied customers, we must rely on them to bring us credibility.

We continue to offer more benefits to our customers. As of January 1, our new interest rate policy will offer accounts with less than \$100,000 in net asset value interest on their qualifying cash. Accounts with less than \$100,000 in NAV will receive interest on their cash at a rate proportional to their account size. An account with the full \$100,000 NAV will continue to earn the entire 1.9% we currently pay in the U.S., while an account with a \$75,000 NAV will receive 75% of that 1.9% rate, or 1.425%, and so on.

We did this to encourage both new customers to open accounts with us and existing customers to consolidate any outside accounts at Interactive Brokers. Together with a growing suite of payment services, such as Direct Deposit, Bill Pay and the IB Debit MasterCard®, our goal is to make it more convenient and profitable for customers to leave their idle cash at Interactive Brokers.

Most competitors we know of continue to pay very little on cash deposits in their brokerage accounts. They pocket your interest, we do not. We want to give customers benefits that increase their returns and profits - and therefore our positive word-of-mouth.

And now I will go over our 5 client segments.

Introducing brokers once again posted the strongest account growth, up 45% over last year and now make up 31% of our overall accounts. Client equity grew 10% for introducing brokers, and commissions rose 36%. We see strong growth in this area because smaller and midsized brokers as well as international ones find it difficult to justify building and maintaining their own technology, so they come to us to white-brand our state-of-the-art technology and to capitalize on our low costs. As various countries and agencies increase their oversight of the financial services industry, the regulatory and compliance burden only grows over time.

Starting early in the fourth quarter, we noticed that some of our accounts in Asia, particularly Mainland China, have taken longer to fund, if they can fund it all, due to constraints on their local banks regarding capital outflows.

Our account growth from mainland China, which was our strongest region, dropped by about 70% in the fourth quarter. We hope to see this improve after international trade issues are resolved over the next couple of quarters.

Individual customers make up 49% of our accounts, 35% of our client equity and half of our commissions. They are a very lucrative and well-diversified customer segment, which saw account growth of 19% for the year, commission growth of 22% and client equity growth of 1%.

The worldwide decline in securities markets in the fourth quarter impacted our customers' account performance, as existing positions in many of our accounts declined in value, even as new fund flows into Interactive Brokers remained quite healthy. Our strong commission growth showed we were able to capture the benefits of increased market volatility.

It is interesting to note that the average age of our nearly 300,000 individual customers is 46 years, ranging from Eastern Europe at 39 years, to the U.S. at 49 years. This demographic bodes

well for our future account growth and customer deposit growth.

Hedge funds constitute 1% of our accounts, 9% of our client equity and 10% of our commissions as of December 31. For the year, we saw 10% hedge fund account growth and 35% commission growth, while client equity declined 6% as most major markets weakened. Hedge funds are a large, multitrillion-dollar global market, and we continue to have tremendous room to grow in this area.

Proprietary trading firms are 2% of our accounts, 10% of client equity and 15% of commissions. For the year, this group grew 7% in accounts, 4% in commissions and 1% in customer equity. As we have said in previous calls, we are well penetrated in this segment, so while we expect it to grow, it will not represent our largest customer development opportunity.

Finally, we have financial advisors. They are 16% of our accounts, 24% of our customer equity and 16% of our commissions. Accounts in this group grew by 11%, commissions by 16% and customer equity by 5%. Our Greenwich Compliance group, which provides registration and compliance assistance for new and existing RIAs, continues to excel at signing up RIAs who want to open their own businesses. Going independent means RIAs can keep all the fees they earn.

In an environment where more advisors are looking to become independent, although commission and financing rates, high rates of interest paid on cash and the availability of Greenwich Compliance's services have all contributed to driving growth in this segment.

Globally, investment advisers have about \$25 trillion in AUM, the largest market segment we are in, so we have plenty of opportunity in this area.

Throughout 2018, we continue to improve existing products and to add new ones, like Direct Deposit and Bill Pay. When an Interactive Brokers customer comes onto our automated platform, they can manage their financial lives with very little interference from us.

In order to be very low cost, as Interactive Brokers is, you must automate, and so we have and

will continue to automate everything we can. This, in large part, explains why we have the highest profit margins despite charging the lowest costs and paying the highest interest rates on cash - our automation. Because the core of our executive team, including Milan, is almost all software developers, everything that moves, we try to automate.

The majority of our new customers come to us by recommendation of existing customers, so the more we do in order for our customers to have a successful experience, the more likely they will enthusiastically recommend our platform to others. The more new customers we onboard now, the more customers they will bring to us in the following weeks and months.

With that, I will turn the call over to our CFO, Paul Brody, who will go through the numbers for the quarter.

Paul Brody

Thanks, Nancy. Welcome, everyone, to the call. As usual, I'll review, in this case, fourth quarter and the full year results so we have much ground to cover, the main factors driving those numbers, and then we will open it up to questions.

Let me begin by highlighting that our headline numbers for net revenues and pretax income imply year-to-year -- year-over-year decreases at 4% and 15%, respectively. But when we remove the effects of noncore operating items, primarily from the 2017 U.S. Tax Act and our currency diversification strategy, these measures increased 17% and 14%, respectively. I'll give more detail on this in my review of the financials.

Starting with operating data, in the fourth quarter, higher market volatility and interest rates led to higher revenues on a firm foundation of growth in customer accounts. Total accounts grew to 598,000, up 24% year-over-year, contributing to client equity growth of 3%, despite declines in many global securities markets. We saw growth in nearly all customer segments, particularly individuals, financial advisors and introducing brokers, although, regionally, as Nancy mentioned, the tightening of capital controls in some parts of Asia has slowed the flow of new funds.

Increased market volatility and higher interest rates gave rise to higher commissions and net interest income respectively. Volatility, as measured by the average VIX, grew significantly to 21, the highest level since 2011 and up from the level of 10 in the fourth quarter of last year.

Increased volatility led to 21% and 34% increases in options and futures volumes, respectively, while stock shares volumes was off 26%. Stock volumes were, once again, impacted by lighter trading in low-priced stocks. As a result of the shift to higher-priced stocks, the number of shares traded declined, but the DARTs and commissions on those trades both rose. Finally, FX dollar volumes fell year-over-year but recovered marginally from the third quarter.

With higher volatility in continuing account growth, our total DARTs for the quarter grew 30% over the prior year quarter, our cleared commission per DART fell 3% to \$3.79, as higher market volatility led to more caution and smaller average trade sizes.

Results for the full year reflected the momentum and operational leverage of our core brokerage business. Full year commissions grew 20% on higher volatility in trade volumes, and net interest income from brokerage grew 38%, as interest rates and average margin loan balances rose. Higher volumes were seen in futures and options, and slightly lower in stocks, echoing the trends of the fourth quarter.

For the full year, total DARTs grew 25% while cleared commission per DART fell 3% to \$3.87, as higher volatility in the first and fourth quarters led to more caution and smaller average trade sizes.

Turning to net interest margin, in our net interest margin table, you'll see that our NIM widened for the fourth quarter to 1.65%, up from 1.43% in the year ago quarter. For the year, NIM grew to 1.62%, up from 1.27% last year. The main drivers were benchmark interest rates, customer cash balances, margin lending and securities lending.

The Federal Reserve raised interest rates again this quarter in late December, making a total of 4 increases over the course of 2018. During the year, we kept a relatively short duration on the U.S. Treasury portfolio, and we recorded mark-to-market gains of \$8 million for the quarter and \$9 million for the year, as market expectations of further rate hikes diminished. We plan to hold

these securities to maturity, so these gains and losses are temporary. But as brokers, unlike banks, GAAP rules require us to mark these securities to market in our financial reporting.

Outside the U.S, interest rates are relatively unchanged with a few modest exceptions like the Canadian dollar. This moderates our expectations on rising net interest income, as about 27% of customer credit balances are not in U.S. dollars.

Increased customer cash balances and U.S. rate increases generated more net interest income. Segregated cash interest income rose 79%, primarily due to Fed interest rate hikes. Our FDIC Insured Bank Deposit Sweep program, introduced just over a year ago, has reached \$1.7 billion and continues to grow and contribute to higher net interest income. This program offers high interest rates in FDIC insurance on up to \$2.5 million of cash in our customers' accounts, in addition to the \$250,000 of SIPC coverage. Note that this revenue is reported in Other Income on the income statement, but it is reported with interest income in the NIM table.

Margin loan interest grew 57% over last year from a combination of factors including, higher average margin loan balances. However, as most major global securities markets fell in the fourth quarter, our customers pulled back somewhat on leverage, with average margin loan balances down 2% from the third quarter.

Securities lending interest income was 51% lower this quarter due to several factors. There were fewer hard-to-borrow high-rate lending opportunities than there were last year, especially in the kind of risk/cost environment that we saw in the fourth quarter. Customer short stock value was down 9% from the prior year-end, reflecting the 6% drop in the S&P 500 and also customers cutting back their market exposure.

On a sequential basis, NIM narrowed by 3 basis points, primarily on declines in margin loans and securities lending income.

Our estimate of the impact of the next 25 basis point increase in U.S. rates is as follows: as we continue to experience growth in customer cash balances, we aim to maximize their net interest income within the constraints of investment instruments permitted by regulations and prudent

liquidity and credit risk management.

Expectations of further rate increases are typically already reflected in the yields of the instruments in which we invest. Therefore, in our calculation, we attempt 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 expect the next 25 basis point unanticipated rise in rates to produce an additional \$15.5 million in net interest income on customer balances over the next 4 quarters, and \$16.2 million as the full yearly run rate. The run rate includes the reinvestment of all of our present holdings at the new, higher rate.

Turning to the segment results, Electronic Brokerage produced gains in both commissions and net interest income for both the fourth quarter and the full year periods. For the fourth quarter, brokerage net revenues were \$490 million, up 26%, and pretax income was \$311 million, up 23%, for a 63% pretax margin.

Treasury marks swung to an \$8 million gain from a \$9 million loss in the year ago quarter. In the expense categories, execution and clearing rose 33% to \$69 million, in line with trade volumes.

Fixed expenses were \$108 million, up 26%, primarily due to increases in employee compensation to expand the growing brokerage business; the previously disclosed migration of expenses related to the winding down of Market Making; increased legal and compliance expenses and contributions to reserves.

Customer bad debt expense was \$2 million this quarter, demonstrating again the continued effectiveness of our risk management systems in limiting customer defaults, even in the face of high-volatility periods.

For the full year, brokerage net revenues rose to a record \$1.84 billion, up 31%, with pretax income reaching \$1.18 billion, up 37% for a 64% pretax margin.

Fixed expenses rose 22% to \$407 million, and adjusted for Treasury marks, pretax margin was also 64%. Market Making continues to consist of customer facilitation activities that will be

retained going forward, and options market making in several remaining profitable markets outside the U.S., which we continue to operate and evaluate for the time being.

For the quarter, net revenues were \$17 million, of which \$7 million were trading gains, and the bulk of the remainder was net interest income. Market Making pretax income was \$9 million. For the year, net revenues were \$76 million, and pretax income was \$34 million. As of the end of 2018, we have nearly fully absorbed the \$40 million of expenses that were projected to migrate to brokerage. Expenses from the customer facilitation activities are largely offset by related revenues, hence such activities should have minimal impact on margins if they are later absorbed into brokerage.

The Corporate segment reflects the effects 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 major currencies this quarter, we incurred an overall loss from our strategy of \$18 million. Of this, \$6 million is reported as Other Comprehensive Income, and \$12 million is included in earnings.

We estimate the total decrease in comprehensive earnings per share from currency effects to be \$0.03, with \$0.02 reported in other income and \$0.01 as OCI. For the year, the overall loss from our strategy was \$99 million, of which \$80 million is reported as OCI and \$19 million included in earnings. The total decrease in comprehensive earnings per share from currency effects for the year was \$0.20, with \$0.02 reported as Other Income and \$0.18 as OCI.

Turning to the income statement, for the fourth quarter, net revenues were \$492 million, down 4% over the year ago quarter that included positive impacts from U.S. Tax Act and the GLOBAL. Adjusted for nonoperating items, net revenues were \$496 million for the quarter, up 17% over last year's \$425 million. Nonoperating items include the \$12 million loss on our currency strategy and the \$8 million gain from Treasury marks in the current quarter, and most significantly, a \$93 million gain related to the U.S. Tax Act, recorded in Other Income for the fourth quarter of 2017.

Commission revenue rose 21% on higher volume in options and futures and, as I mentioned earlier, higher DARTs and stocks, partially offset by lower average trade sizes in most product categories. The modest decline of our overall average cleared commission per DART to \$3.79 reflected this mix. Of our \$243 million of net interest income, brokerage produced \$234 million, Market Making, \$8 million, and Corporate the remainder. Other income, which includes our GLOBAL currency strategy, Treasury marks and other fees and income we received was \$37 million. The nonrecurrence of last year's \$93 million U.S. Tax Act benefit and the modest decline in the GLOBAL offset increases in Treasury marks and in most other line items.

For the full year, net revenues were \$1.90 billion, up 12% over the prior year. Full year adjusted net revenues are \$1.91 billion, up 28% over last year's \$1.50 billion. Noncore items for 2018 include the \$19 million loss on our currency strategy and the \$9 million gain from Treasury marks. For 2017, the primary noncore items were a \$110 million gain on the GLOBAL and \$93 million gain related to the U.S. Tax Act, an \$11 million gain on the transfer of our Market Making business and a \$12 million loss from Treasury marks.

Noninterest expenses were \$183 million for the quarter, up 21% from last year. The primary drivers were \$17 million higher execution and clearing fees, in line with increased trading activity, as well as higher general and administrative expenses, largely stemming from legal and compliance costs and reserves.

For the full year, noninterest expenses were \$707 million, up 8%, driven primarily by the same factors, plus higher employee compensation and benefits. At year-end, our total headcount stood at 1,413, 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.

For the fourth quarter, pretax income was \$309 million, down 15% versus last year, which contained the noncore items I noted. On an adjusted basis, pretax income was \$313 million, up 14% over last year's pretax income of \$274 million, representing an adjusted pretax margin of 63%. And for the full year, pretax income was \$1.20 billion, up 14%, and adjusted for the noncore items was \$1.21 billion, up 38% versus last year's \$872 million.

Diluted earnings per share were \$0.57 for the quarter versus a loss of \$0.02 for the same period in 2017. Without the impact from noncore items, diluted earnings per share would have been \$0.58 for the quarter versus \$0.43 in the year ago period.

For the year, diluted earnings per share were \$2.28 versus \$1.07 last year. And adjusted for the noncore items, including the U.S. Tax Act in 2017, diluted earnings per share were \$2.28 for 2018 and \$1.39 for 2017.

Comprehensive diluted earnings per share, which includes all currency effects were \$0.56 for the quarter versus a loss of \$0.02 last year. And for the year, they were \$2.09 versus \$1.22 last year. Ex the noncore items, full year comprehensive diluted earnings per share would have been \$2.28 versus \$1.39 last year.

To help investors better understand our earnings, the split between the public shareholders and the noncontrolling interest for the fourth quarter is as follows: Starting with income before income taxes of \$309 million, we first add \$1 million of other income, actually net expense in this case related only to the public company, resulting in \$310 million of operating company's income. We then deduct \$9 million for mostly foreign income taxes paid by our operating companies. That leaves \$301 million, of which 82%, or that \$247 million reported on our income statement, is attributable to noncontrolling interests. The remaining 18%, or \$54 million, is available for the public company shareholders but, as this is a non-GAAP measure, it is not reported on our income statement. After we deduct that \$1 million of net expense reported in other income from the \$54 million and then deduct remaining taxes of \$10 million, the public company's net income available for common stockholders is the \$43 million you see reported on our income statement. So our income tax expense of \$19 million consists of this \$10 million plus the \$9 million of taxes paid by the operating companies.

Our balance sheet remains highly liquid with low leverage. With a record \$7.2 billion in consolidated equity, we are extremely well capitalized from a regulatory standpoint, and are deploying our equity capital in the brokerage business as it continues to grow. We hold excess

capital in order to take advantage of opportunities, as well as to demonstrate the strength and depth of our balance sheet. We continue to carry no long-term debt.

At December 31, margin debits were \$27 billion, a decrease of 13% from last year. Multiyear highs in volatility, combined with a downdraft in global securities markets, especially in the fourth quarter, led to our clients curtailing leverage. As we noted in previous calls, we also expect swings in margin lending due to our success in attracting institutional hedge fund customers, who are more opportunistic in taking on leverage. We remain able to satisfy customers' willingness to take on leverage when market yields present these opportunities.

Out of our consolidated equity capital at December 31, 2018 of \$7.2 billion, \$5.8 billion was held in brokerage, \$1.0 billion in Market Making and customer facilitation activities and the remainder in corporate. Now I'll turn the call back over to the moderator, and we can take some questions.

Question-and-Answer Session

Operator

(Operator Instructions) Our first question will come from Rich Repetto with Sandler O'Neill.

Rich Repetto

First, I want to congratulate Thomas for building an outstanding company and really setting the standard for the active trader platform that you've built. Congratulations.

Thomas Peterffy

Thank you, Rich.

Rich Repetto

So I guess the first question is, just trying to get into more of the details. On the incremental interest expense, when you're paying below \$100,000 -- the accounts with \$100,000, so we ballparked at somewhere between \$20 million to \$30 million per year with the different moving parts. I guess, could you help us, since this is a public format, is that reasonable? And I don't

know whether you could narrow it down any more than that.

Paul Brody

So we did some modeling on that, Rich, of course. So our estimate is: with current balances and no changes at all, it's a little bit under \$20 million annual additional interest expense. However, that translates into only about 2.5% of balances. That is to say, if the policy attracts only about 2.5% of our credit balances as an increase then we break even, and if we attract more than that, then it's a successful policy.

Rich Repetto

Got it. So \$19 million on current balances then?

Paul Brody

\$19.5 million was the modeling, but it's only -- it has certain assumptions, so therefore, take it as an estimate.

Rich Repetto

Got it. And then I guess, the next question would be on expenses overall, is it still -- I guess, the guidance has been expenses will grow somewhat at the pace of revenue, or could you give us, Thomas, I guess, the overall guidance for expenses as you continue to try to scale up and build the broker?

Thomas Peterffy

I would expect expenses to grow 10% to 15%.

Rich Repetto

Got it. Okay. That's very helpful. And then my last question, Thomas, is I guess, we can see the headwinds that are out there, or some of the headwinds that you've mentioned about the Asia problem with money coming out of Asia, as well as the smaller trade size issue. And you brought that up on the past several calls with regulators sort of giving that more scrutiny to the low-priced stocks. And I guess, just to look at it from the tailwind side, what are the things besides volatility,

we know that will help, but what are the things that you think can help overcome some of these -- the headwinds that may be temporary hopefully, but what are you seeing that keeps you real optimistic, I guess, just to reduce some of those?

Thomas Peterffy

I think, clearly stated, it's growth. It's growth of accounts. That's what this business is all about. Accounts will keep on growing, and we are getting new accounts in all of our segments. And it looks really good, but of course, at the beginning of the year, everything looks good. But this year, it really is looking good.

Operator

And our next question will come from the line of Chris Allen with Compass Point.

Chris Allen

I'll offer my congratulations as well, Thomas. It's been a pleasure to watch the growth over the years. If I can just actually dive a little bit deeper into kind of some of Rich's questions. One, just in the Asia-Pac region, is it just China that you're seeing the impact or is it a little bit more broader than that? And also, I mean, from your comment just now, it sounds like 2019 is off to a good start. Have you seen consistency in North American and Europe and the other regions i.e. this is just -- a little bit of just the China-U.S. issue? Or are we also seeing an impact from the market pullbacks that we saw over the course of the fourth quarter? I mean, both of which if we kind of think of it, longer term will fade but I just want to hopefully try to delineate between the two.

Thomas Peterffy

I think it's mainly a China-U.S. issue, and it's not only the difficulty of mainland Chinese customers trying to take money outside of the country, but it's also the Chinese stock market. As you know, the Chinese stock market has not done well in this past year, and many of our Chinese customers, in fact, carry Chinese stocks with us. So their accounts' size has -- or the value of their accounts -- has diminished drastically because of their long position in Chinese stocks.

Otherwise, as far as Asia is concerned, our account growth has picked up in the countries outside

and around China. Countries like Singapore and Hong Kong and other countries in the area. Similarly, our account growth is picking up in Eastern Europe and even in Latin America. So while in the United States, our account growth is fairly stable at a relatively lower rate of around, in the low teens, in other places, we go up in the 20s and 30s. So that's what we see.

Chris Allen

Got it. That's very helpful. And I think the other brokers would take mid-teens in the U.S. from an account growth perspective! Just wanted to ask also on kind of the expense outlook, the 10% to 15%. One, is that kind of the outlook for the fixed expense base, or does that include execution and clearing? And two, do they encompass new projects that you guys are working on. You guys are always working on something whether, I mean, I think you mentioned at the Goldman Conference, looking at the potential for a bank in the U.S. or outside, just an example of things you think about. But any color there would be helpful.

Thomas Peterffy

I was talking about fixed expenses. Execution is clearing and it's not under our control. I hope it will grow by a huge percentage because it goes hand in hand with our commission income. The greater the commission income, the greater the execution expense. So we're basically, focusing on - keep hiring more and more people with expertise in software development especially; and in compliance. And so we hope to grow expenses, so this is not -- this is a pleasure for us to grow the expenses because that means that we are able to recruit the talent, because we really, really need people in order to make this business grow as fast as we can.

Operator

And our next question will come from the line of Mac Sykes with G. Research.

Mac Sykes

I would echo the comments Thomas and congratulations Milan. Looking forward to the next 28 years as well. Thomas, we always look forward to your color on the markets. And I just wanted to throw a couple of questions on that framework. First, we've got an announcement recently about a new exchange, the MEMX. I know it's still early days, I just wanted to get your feedback

on the need for a new exchange and what are some of the dynamics that might bring? Also, maybe an update on how you thought markets functioned in December, in terms of passive in the system? And then perhaps, an update on payment for order flow going forward in terms of market structure.

Thomas Peterffy

This is a 3-part question that has only one answer, basically. So as far as this new U.S. exchange is concerned, I can only guess as to the motives, and I think that maybe some brokers were given some heat about payment for order flow. And so they are trying to transfer the business in which they hand over their orders to the internalizers over the counter; they are trying to do the same thing now on an officially registered exchange, so it's sort of looks better. I think the business is going to be probably the same. Payment for order flow, we do not see or expect any change. As far as liquidity is concerned, I think we are -- the more orders that get purchased by internalizers, whether it's this new exchange or otherwise, I think the liquidity will lessen further, because these orders never see daylight. And obviously, people who can put limit orders on the exchanges are doing that in the hopes of getting to trade with some customer orders and that is not happening. So I think that liquidity is going to continue to degrade as payment for order flow takes a greater and greater percentage of the overall volume.

Mac Sykes

Okay. And then just one follow-up on the China, Asia aspects. Assuming we do get a trade deal done and markets in China and that area kind of stabilize. I mean, would you think that there's some compressed demand at this point that could -- so we could see kind of a knee-jerk reaction in terms of engagement following kind of a broader headline of...

Thomas Peterffy

I do not know how the capital controls are actually connected with the -- with the trade fight. We sense that there is some connection. We sense that the capital controls get harder as the trade fight gets harder. But we cannot promise you that if the trade fight resolves itself, the capital controls will be lifted. So we hope, but there are certainly no assurances that we can give you on that.

Operator

And our next question will come from the line of Kyle Voigt with KBW.

Kyle Voigt

Just another question on China, if I could. I think you previously disclosed around 16% of your accounts were from China. Just to clarify, is that 16% figure mainland China only or is that a different account?

Thomas Peterffy

That was mainland China.

Kyle Voigt

Okay. And then just one more on China, and then I'll move to something else. In October, Bloomberg reported that Tiger Brokers was considering a U.S. IPO alongside another China-based broker, I know IB made an investment in Tiger in 2017. Just wondering if the potential broker IPOs change anything for IB from a business perspective? And then more broadly, if you could address the competitive environment in serving mainland China outside of this trade dispute? I think you made some comments earlier in the year about maybe new or different competitors likely to emerge over the coming years.

Thomas Peterffy

So we do not expect any changes, as far as our business is concerned, from Tiger Brokers going public. Maybe it will, to some extent, increase their business, and since we do their business, it would increase ours. But I do not expect a major impact. Now as far as the competitive landscape, we haven't seen any major changes, and there are these online brokers like Tiger and Futu. And I assume that there are others that are forming in the background, so I expect that in the long run, we will have more and more competitors or customers, it is hard to tell which one. If we succeed in getting them to become customers of ours then we'll have -- it's good for us. If we do not, it's not so good for us. But China is -- even though it's 16% of our accounts now, I expect that as the rest of the world becomes more capital- and investment-conscious that

percentage will probably diminish somewhat.

Kyle Voigt

Okay, understood. Just another question for you, Thomas, regarding the trading plan that will become effective in July. Just to confirm, do you anticipate potentially increasing the pace of the share sales -- sales in futures trading plans or is that just...

Thomas Peterffy

NO, no, I do not. No.

Kyle Voigt

Okay. And then lastly, for me, and then I'll hop back in the queue is - I just had a question regarding the securities portfolio. I think from the beginning of 2016 through the middle of 2017, you significantly shortened the duration of that securities portfolio. Just given at the market is pricing in a relatively low probability of the Fed hiking again, how are you thinking about the duration of that securities portfolio as we're heading through 2019?

Thomas Peterffy

I think that it's just my thinking that they may have a pleasant surprise and the economy could perk up, and we could get 1 or 2 rate hikes in 2019 but don't hold me to that.

Operator

(Operator Instructions) And our next question will come from the line of Chris Harris with Wells Fargo.

Chris Harris

The change in your interest policy, how is it only affecting 2.5% of the balances? I was under the impression that balances under \$100,000 were a much larger percent of the total.

Paul Brody

Maybe I wasn't clear when I said - the 2.5% we are talking about is that, based on that

incremental expense under the new policy on the current balances, if we were able to attract as little as 2.5% additional balances, because we are paying more interest, and we can get customers to consolidate more balances with IB, if we are able to attract as little as 2.5% more, that would cover the additional cost. And then any amount over 2.5% means it's a successful policy for us. So it's a fairly low bar.

Chris Harris

Okay, clear. With respect to the slowdown in accounts, are you guys seeing any slowdown from your hedge fund customer group? And I ask that question because there had been some hedge fund closures. The fourth quarter was difficult from a performance standpoint for a lot of funds. So is that starting to make its way through your business or not?

Thomas Peterffy

We have not seen that yet.

Chris Harris

Okay. And then one quick, last numbers question. Can you walk us through the difference between the net interest income you guys report on a consolidated basis versus the net interest income that's in the table? Looks to be like a \$9 million variance between those 2 numbers.

Paul Brody

Yes, so just conceptually, there are elements that are reported as either interest income or reported in the Other Income line item on the income statement, according to what GAAP requires. And so there are interest-like elements that might be related to, for example, foreign exchange swaps, which we do on a very short-term basis for Treasury management and to improve our overall interest picture, that effectively generate interest income, but GAAP doesn't consider that interest income, so it might be reported as Other Income. All -- we take all of these items for analysis purposes and bring them into the net interest margin table, so that everything that's either clearly net interest or a net interest-like line item are all brought together so that we can see the whole picture. Another good example is the FDIC Sweep program, because technically, it generates fees, not interest. And so on the income statement, it's in Other Income,

and in the net interest margin analysis in the table, it's in there along with interest income.

Operator

And I am showing no further questions at this time. It is now my pleasure to hand the conference back over to Mr. Nancy Stuebe for any closing comments or 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 the site tomorrow. Thank you again, and we will talk to you next quarter end.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude our program, and we may all disconnect. Everybody, have a wonderful day.