

Summary:

Interactive Brokers LLC

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Summary:

Interactive Brokers LLC

Credit**Rating:** A-/Stable/A-2

Major Rating Factors

Strengths:

- Strong profitability and good fixed-cost coverage
- Relatively conservative financial profile, including strong capitalization

Weaknesses:

- Highly competitive, volatile options market-making business
- High operational and model risks
- Key-man risk

Rationale

Standard & Poor's Ratings Services' ratings on Interactive Brokers LLC (IBLLC) reflect our opinion that it is a "core" operating subsidiary of its parent, IBG LLC (IBG). Our ratings on the consolidated IBG reflect the firm's adequate business profile and relatively conservative financial profile, supported by its solid capitalization, adequate liquidity, and strong, but often volatile, earnings. We believe these strengths are partially offset by the highly competitive and transactional nature of the firm's market-making and electronic brokerage businesses and exposure to model and key-man risk, as well as the influence market volatility and volumes have on IBF's revenue.

IBG operates two business segments: market making (Timber Hill) and electronic brokerage (IBLLC). The electronic brokerage segment provides market access and execution, as well as margin financing, clearing, and custody to both institutional and sophisticated retail investors. We view favorably the brokerage's unique franchise, limited principal risk, and simple balance sheet. Although IBLLC typically has slightly lower profit margins, its results are not as volatile or correlated with market conditions as Timber Hill's. That said, market conditions influence its trade revenue and margin loan volume. The company is disciplined in managing its expenses and strives to be the low-cost provider. IBG's other segment--Timber Hill--is a major global electronic marketmaker in exchange-listed options, stocks, bonds, foreign exchange, and futures at more than 100 market centers worldwide. The market-making segment has historically been the larger earnings contributor, although not as consistently recently. Growth in the electronic brokerage business, combined with maturing international operations, helps to diversify IBG's overall business.

Timber Hill uses proprietary computer models to make markets in thousands of individual securities. The model has an excellent track record on pricing and containing risk. However, we believe Timber Hill's reliance on models and advanced systems exposes the firm to substantial operational and potential market risk. Timber Hill's strong trading results during the tumultuous second half of 2008 demonstrated the extent to which its market share, market volatility,

and volumes--not market direction--drive its results.

Timber Hill's profitability and market share remain supportive of the rating, but since 2010 they have suffered from competition and less favorable market volumes and volatility. We believe the proliferation of advanced technology and expertise has made competition more effective. We expect Timber Hill to remain profitable and would view an increase in risk or efforts to chase market share unfavorably.

IBG's substantial amount of equity capital, reasonable leverage, and good risk-adjusted capital adequacy characterize its financial profile. Management has paid out large special dividends from time to time, but we expect it to maintain limited leverage and not materially reduce the amount of tangible equity. We believe a solid financial profile, particularly a large amount of excess tangible equity, is necessary to offset the substantial operational and market risks and reliance on wholesale funding. IBG has a good track record of managing its risks, but we believe that its expansion--particularly internationally--adds complexity and increases its exposure to operational, regulatory, and other risks. In addition, IBG is still maturing as a public company, particularly concerning governance, and has some exposure to key-man risk stemming from founder, controlling shareholder, and CEO Thomas Peterffy.

Despite IBG's dependence on wholesale funding, we consider liquidity adequate for the rating because of the company's relatively simple balance sheet and focus on liquid exchange-traded securities inventory.

Outlook

The stable outlook reflects our expectation that IBLLC will remain a core IBG subsidiary. It also reflects our belief that the consolidated IBG's continued solid margins and strong capitalization should buttress its financial profile. We expect IBLLC and some of the international operations to continue to expand, which could reduce its dependence on U.S. options-market volumes and equity-market volatility. The firm's business model and the uncertainty associated with ongoing structural reforms in the financial services industry limit upgrade potential at this time. Ratings would come under pressure if the market-making business suffers prolonged revenue compression or starts to report operating losses, or if we believe the firm's commitment to maintaining a solid financial profile and strong capitalization is decreasing. We would likely lower the ratings if the firm decreases the amount of equity materially below that of recent periods or increases leverage such that its adjusted total equity-to-managed-assets ratio falls to less than 10%. Any material decrease in liquidity or increase in risk, including a shift into materially different or higher-risk businesses, could also lead to a downgrade. However, over the long term, we could consider raising the ratings if IBG maintains a strong financial profile, lowers principal and operational risk, becomes more diversified, and continues to develop its governance.

Related Criteria And Research

- Criteria | Financial Institutions | General: Group Rating Methodology And Assumptions, May 7, 2013
- Criteria | Financial Institutions | Broker-Dealers: Rating Securities Companies, June 9, 2004

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