S&P Global
Ratings

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Summary:
Interactive Brokers LLC

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Summary:

Interactive Brokers LLC

Credit Rating:	BBB+/Stable/A-2

Major Rating Factors

Strengths:

- Core subsidiary of IBG LLC
- Consolidated group's very strong capitalization
- Growing, geographically diverse, low-cost brokerage business

Weaknesses:

- Consolidated group's operational risk driven by the complex model-driven options market-making business
- Earnings are mostly transactional in nature
- Brokerage customer confidence sensitivity

Outlook

The stable outlook on Interactive Brokers LLC reflects S&P Global Ratings' expectation that the entity will remain a core subsidiary of IBG LLC and that it will continue to grow as IBG's market-making business transitions. Further, it reflects our expectation that the firm's consolidated risk-adjusted capital (RAC) ratio will remain above 20%, the gross stable funding ratio (GSFR) in excess of 110%, and the liquidity coverage metric (LCM) above 90%.

We could raise the ratings on IBG LLC and Interactive Brokers LLC if the firm continues to diversify its client base toward more sticky and less confidence-sensitive retail and financial adviser clients, maintains its commitment to hold very strong levels of capital, and successfully manages its margin loan exposures with minimal losses. We could also view the sale of the firm's market-making segment positively if the firm retains the capital from the sale.

We could lower the ratings if the consolidated RAC ratio falls to less than 20%, if IBG suffers a material loss, or if its liquidity coverage metric deteriorates below 90% on a sustained basis.

Rationale

Our ratings on Interactive Brokers reflect our opinion that the company is a "core" operating subsidiary of its parent, IBG. Our ratings on IBG and Interactive Brokers reflect the consolidated firm's solid market position, very strong capitalization, and good earnings. We believe these strengths are partially offset by exposure to model and operational risks and the highly competitive and transactional nature of the firm's market-making and electronic brokerage businesses.

Since Interactive Brokers is a "core" subsidiary of IBG, our rating on the company is at the same level as the group credit profile ('bbb+'). The rating on IBG is one notch lower than the group credit profile to reflect its structural subordination as a nonoperating holding company.

We believe IBG has a solid market position with an established presence as a major global electronic market maker and broker in exchange-listed options, stocks, bonds, foreign exchange, and futures at more than 100 market centers worldwide. The firm continues to expand its brokerage business, with total accounts up 15% year over year. We expect the brokerage business to continue to grow as its high functionality and low prices attract customers to the platform. However, the firm's earnings are largely transactional in nature, which we view as potentially somewhat less stable than contractually recurring fees and stable sources of net interest income.

We view favorably IBG's growth in retail and financial adviser clients as we believe these customers are more sticky and less confidence-sensitive than institutional clients like hedge funds and proprietary trading companies. We would view negatively an increase in institutional clients because of their relatively higher risk given their use of portfolio margining and confidence-sensitive nature.

We view IBG's capitalization as very strong given the firm's consolidated RAC ratio of 31% as of Sept 30, 2016, and limited risk appetite. We expect the retention of earnings to support the firm's capitalization as the brokerage business continues to grow.

We believe the firm's risk management and loss experience remain supportive of the rating despite a few outsized loss events over the last few years. As of Sept. 30, 2016, IBG had approximately $3 billion of total adjusted capital above our 15% threshold to maintain its "very strong" capital assessment. We believe that the strength of IBG's capitalization helps to offset the consolidated firm's exposure to low-probability, high-impact operational risk events from its reliance on models and technology to execute and manage the risks of its high trade volume.

We view the consolidated firm's funding and liquidity as supportive of the rating given that its GSFR and LCM remain above our thresholds for a downgrade. The consolidated firm's GSFR, which measures the extent to which a firm uses stable funding to finance its less liquid assets, was 151% as of Sept. 30, 2016, and its LCM--balance sheet liquidity sources divided by balance sheet liquidity needs--was 99%. The company has additional funding needs related to its large amount of open option positions, which are not reflected in the GSFR.

The company has started exploring strategic options for its market-making business, including a potential sale or partnership. While we believe the sale of this business would likely reduce the firm's market and operational risk considerably, the ultimate impact on the rating would depend on the extent to which this business's risks have been removed, whether IBG retains the segment's capital, and what the impact is on the firm's funding and liquidity.

Related Criteria And Research

Related Criteria

- Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012

- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- IBG LLC, Dec. 1, 2016