

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

## **Q2 2020 Results - Earnings Call Transcript**

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### **Executives**

**Thomas Peterffy - Chairman**

**Paul Brody - CFO**

**Nancy Stuebe - Director, IR**

### **Analysts**

**Will Nance** *Goldman Sachs*

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

**Rich Repetto**, *Piper Sandler*

**Chris Allen**, *Compass Point Research*

**Craig Siegenthaler**, *Credit Suisse*

### **Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the Interactive Brokers Group Second Quarter Financial Results Conference Call. At this time, all participant lines are in a listen-only mode. After the speakers' presentation, there will be a Q&A session. To ask a question during the session, you will need to press "star one" on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press "star zero." I would now like to hand the conference over to your speaker today, Nancy Stuebe, Director of Investor Relations. Thank you. Please go ahead, ma'am.

**Nancy Stuebe**

Good afternoon, and thank you for joining us for our second quarter 2020 earnings conference call. 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.

We continued to see strength in our business as more people in more countries chose to invest in the markets. Accounts rose 36% year-on-year to 876,000, as we added 116,000 net new accounts in the quarter. In the second quarter, we brought on more new accounts than we have ever added in a full year. This quarter's growth implies an annualized account growth rate of 60%.

We saw growth in all client segments and all geographic regions, with areas outside the U.S. particularly strong. Our growth outside the U.S. has become more evenly distributed among countries and regions over the past couple of years. In an active market environment, this diversification has contributed to our growth as increasing numbers of investors around the world seek to participate by using our platform.

Client equity rose above \$200 billion for the first time and ended the quarter up 33% at \$203 billion. Over the course of the quarter, clients grew more comfortable with putting money into the market and taking on leverage, leading to client trading levels increasing and our margin loan balances recovering.

As clients traded more actively during unusually high market volatility, our total DARTs reached over 1.7 million, more than doubling from last year, and cleared average DARTs per account rose 64% to 480.

Our platform is highly automated, so adding an additional customer to it costs us very little, and any activity they initiate is profitable for us. That is why we focus on growing our customer base, in all segments and regions, so we can take advantage of higher activity in any market scenario.

In addition, our platform offers worldwide access to securities ranging from equities, fixed income, funds, derivatives, and FX, among other products. Our diversity means we can capture extra activity regardless of the type of security or geographic area in which it occurs.

However, not everything was as we would have wanted at Interactive Brokers this quarter. As we announced in April, our systems did not perform as we would have wanted during the extreme price movements around the WTI index on April 20th.

Both the CME and ICE Europe use the price of physically-settled oil futures to determine the settlement price for their cash-settled futures products. Historically, that mismatch between physical settlement and cash settlement had not been a problem. However, on April 20th, worries over the lack of availability of oil storage drove the price of the physical oil futures deep into unprecedented negative territory. So, even though a cash-settled contract would, of course, not have to face this issue, the CME and ICE pricing mechanisms meant they were priced as if they did.

Several of our customers held long positions in the cash-settled CME and ICE contracts, and as a result they incurred losses, some in excess of the equity in their accounts. We fulfilled all the required settlements with the various clearinghouses, and felt it right to compensate certain affected customers in connection with their losses. All told, our aggregate loss was \$104 million.

Since then, we have successfully programmed and tested our systems to ensure such an event does not impact us like this again. Further, we tightened some parameters around the trading of oil futures. Aside from this event, and despite extremely high market volatility this quarter, our bad debt expense was a modest \$2 million.

On interest rates, the new zero- (and negative) interest regimes in the US and around the world have impacted our net interest income. Higher margin loans, an influx of cash into new and existing customer accounts, and a strong securities finance performance led to \$190 million of net interest income for the quarter, despite our segregated cash and securities yielding only 34 basis

points. We have already seen the bulk of the impact of the Federal Reserve's move to zero rates on our segregated cash and securities interest rate, though if rates hold steady, there could be further declines as our longer-term holdings mature.

Finally, our total equity reached over \$8.25 billion dollars in the second quarter, our highest to date. With no debt, our balance sheet remains strong. As we continue to grow and add larger and institutional accounts, our equity capital helps us attract these customers.

We saw growth in all five of the client types that we service. I will now go over our five client segments.

Individual customers, which made up 55% of our accounts, 36% of our client equity and 52% of our commissions, continued to be our fastest growing segment, with 12-month account growth of 50%, client equity growth of 35%, and 30% growth in latest-12-months' commissions. All geographic regions we serve saw growth over 30%, with Europe and Asia continuing to grow faster than the Americas for now. Once again, this demonstrates investor demand for a reliable platform with a wide choice of products and international markets, which can maximize investment opportunities. Interactive Brokers is a "stay at home" company, so individuals, now that they have the time to do so, want to invest and manage their money.

Proprietary trading firms are 2% of our accounts, 11% of client equity, and 15% of commissions. This group grew accounts 19% for the 12-month period, 40% in client equity, and 28% in commissions. As prop trading firms are sensitive to the direction of volatility, this quarter's sustained high volatility offered them numerous opportunities. Prop traders tend to have more active trading strategies, which benefit from our low-cost platform that provides access to securities around the globe.

We continued to see growth in the hedge fund customer segment. For the 12 months ended June 30, we saw 4% hedge fund account growth, 18% customer equity growth, and 11% commission growth. This segment was particularly strong in the Americas and Asia this quarter. Growing word of mouth, our reputation for best price execution and low margin rates, and the quality of our platform are behind this growth. Hedge funds represent 1% of our accounts, 8% of our client equity, and 8% of our commissions.

Financial advisors are 13% of our accounts, 19% of our customer equity, and 14% of our commissions. This group grew accounts by 11% for the 12-month period, while customer equity rose 11%, and commissions 6%. As advisors tend to be more conservative in their activity, their commission growth tends to grow more slowly in periods of high volatility.

Our final segment is Introducing Brokers. These represent 30% of our accounts, 26% of our client equity, and 11% of our 12-month commissions. I-broker segment account growth was 27% for the latest 12 months, with 54% client equity growth, and 44% in commissions. Introducing Brokers build their own businesses under their own name, gather their own customers, create their own marketing and provide their own client service; Interactive Brokers does the back-office clearing and processing at low cost. Our ability to offer global markets and products, along with seamless back office functionality, has allowed us to grow in regions where customers may not be large enough to draw the attention of bulge bracket banks or, even if they did, would be charged extremely high prices for international access. We have seen that as more people worldwide seek to trade on recent market volatility, or to diversify their assets, they want to be able to access many markets and products.

Turning to new products, new offerings this quarter included:

Our Securities Class Action Recovery Service, an automated solution we created to relieve our clients of the administrative burden of recovering amounts due them from a securities class action lawsuit.

A “Shortable Instruments” tool, so clients can search for availability and rates for shortable stocks and bonds directly from their Client Portal.

A redesigned Fundamentals Explorer tool, giving our clients access to Thomson Reuters fundamental data on over 30,000 companies – for free.

A Tax Optimizer tool so clients can both try out different lot matching methods to optimize a trade’s cost basis, and analyze their long-term and short-term gains or losses, and finally

Margin borrowing in Australia for both individual and corporate retail customers.

We continue to see better responses from our digital marketing efforts since year-end, a development we hope will continue.

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

### **Paul Brody**

Thank you, Nancy. welcome everyone to the call, thanks for joining. As usual, I will first review our operating results and non-core items. My comments will follow the format of the earnings release, after which we will open the call up for Q&A. As a reminder, in the first quarter, we began reporting without separate business segments, as our remaining market making activity is no longer material to our overall results.

At that time, we also separated two line items “Other fees and services” from “Other income”. “Other fees and services” contains recurring items such as market data fees and FDIC bank sweep program income; while “Other income” consists of currency impacts, US Treasury marks to market, principal trading activities and other investment gains or losses that are less predictable in nature. The continued global impact of the coronavirus was a likely contributor to the highly active markets worldwide.

Volatility, as measured by the average VIX, more than doubled to 34.9 in the current quarter, from 15.2 in the same quarter last year. However, the current quarter was more consistently volatile than the 1<sup>st</sup> quarter of 2020, when the VIX spiked to over 82 for a short time in March; this quarter, the VIX ranged from 24.5 to 57, reflecting consistently active markets.

Quarterly total DARTs increased 111% to a record 1.75 million compared to the 2<sup>nd</sup> quarter of 2019. Our customer trade volumes continued to rise dramatically in every product class, led by increases of 64%, 34%, and 63% in options, futures, and stocks, respectively. FX dollar volumes were strong as well, increasing 55%. Total accounts reached 876 thousand, up 36% over the prior year, with quarterly net new accounts added at a pace 5 times higher than last year’s 2nd quarter. This contributed to customer equity growth of 33% to \$203.2 billion at quarter-end.

Our overall average cleared commission per commissionable order fell 24% versus last year, to \$2.81, on a product mix that featured smaller average trade sizes in stocks, futures and FX, and slightly larger in options. Smaller trade sizes are often seen in high volatility periods, as traders choose to risk less per trade in fast-moving markets.

Moving to our Net Interest Margin table, our net interest margin narrowed from 1.66% to 0.99%. In five separate actions since the year-ago quarter, the Federal Reserve brought its benchmark target rate down to near zero. The average effective Fed funds rate, which we use to price our margin loans and interest paid on customer cash, fell from 2.4% in 2Q19 to 0.06% in 2Q20. While this significantly lowered what we paid on our customer credit balances, it also reduced our earnings on segregated cash and margin loans. Nevertheless, our net interest margin narrowed just 67 basis points over this period, supported by successful segregated cash management and strong securities lending.

Despite the Fed lowering the overnight interest rate, the yield curve remained flat, as it has for several quarters. We have kept the duration of our portfolio relatively short and recorded a mark-to-market loss of \$13 million on our holdings of U.S. Treasuries, making us roughly flat for the year to date.

As always, we plan to hold these securities to maturity so any gains and losses on our marks-to-market each quarter should trend towards zero over time, but as brokers – unlike banks – GAAP rules require that we mark our portfolio to market in our financial reporting. Outside the US, benchmark interest rates remained near or below zero for many currencies, as central banks continued to attempt to soften the impact from COVID-19 on their economies.

Despite a 29% increase over the year-ago quarter in customer credit balances, the reduction in our expense of interest paid on these balances was the largest contributor preventing our net interest margin from falling further. We continue to have success in asset gathering, and our FDIC Insured Bank Deposit Sweep program maintained its steady growth, reaching an average of \$3 billion, up nearly \$1 billion from last year.

Margin lending and securities lending were the largest contributors to our net interest margin. Average margin loan balances fell 13% from last year. However, due to significantly lower benchmark interest rates, margin loan interest income fell 65%. Margin loans have shown a steady bounce back, ending the quarter at \$25.7 billion, about 13% over the average for the quarter. Securities lending interest income was up 67% this quarter versus a year ago, as we successfully capitalized on more hard-to-borrow names that investors were looking to short.

On segregated cash, despite a 66% increase in segregated cash balances, lower investment rates led to a 73% decline in interest income. Several factors cause the yields on our segregated cash to differ from the change in Fed funds rate: First, a portion held in other currencies; and, second, given an average duration of investment in Treasuries of about 35 days reinvestments take place over time. So, some of our investments of segregated cash would not be expected to follow Fed rate declines immediately.

The increase in segregated cash balances is a function of higher customer credit balances and lower margin lending. While investors were more comfortable taking on leverage this quarter, over time the growth in our clients' cash is consistent and outpaces the variable growth and contraction in margin loans. Note, too, that the FDIC sweep program removes funds that would otherwise be included in our segregated cash balances from our balance sheet for accounting purposes.

Now, for our estimate of the impact of the next 25-basis-point-increase in rates:

When calculating the impact of rate changes, we understand that as the possibility of a future rate increase becomes more certain, this expectation is typically already reflected in the yields of the instruments in which we invest. Therefore, we attempt to isolate the impact of an unexpected rise or fall in rates, separate from the impact of rate hikes or cuts 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 \$96 million in net interest income over the next 4 quarters, and \$110 million as the yearly run rate, based on our current balance sheet.

These numbers are highly sensitive to benchmark rate changes due to the impact of low rates on the spread between what we earn on our segregated cash and what we pay to our customers. As US rates fell below 50 basis points, our spread compressed as we earned less when investing our segregated cash. However, the converse is also true, that as rates move back up toward 50 basis points, our spread expands significantly.

The run rate includes the reinvestment of all our present holdings at the new, assumed, rate, but does not take into account any change in how we manage our segregated cash. If we are successful in continuing to grow our customer assets, higher cash and margin lending balances will provide some offset to the loss of net interest income from low benchmark rates, should they persist.

Turning to our income statement. As I mentioned earlier, in 2020 we began reporting our consolidated numbers only, and no longer report segments. We define non-core items as those not part of our fundamental operating results. Non-core items included four items this quarter:

First, our currency diversification strategy produced a gain of \$16 million versus a \$6 million loss last year; Second, a mark-to-market loss on US government securities of \$13 million, versus a gain of \$5 million last year; third, a gain on our investments of \$13 million, versus a loss of \$74 million last year; and finally, an unusual customer expense of \$104 million on the WTI event, versus no equivalent in the year-ago quarter. The net effect of these adjustments reduced pretax income by \$88 million in this year's quarter, and by \$75 million in last year's quarter.

Net revenues were a reported \$539 million for the quarter, up 31% versus last year's second quarter. Excluding non-core items, net revenue was up 7% to \$523 million. Commission revenue rose 55% on significantly higher volumes in all product categories. Net interest income fell 24% to \$196 million, largely due to the drop in the average effective Fed funds rate versus the year-ago quarter. Other fees and services revenues rose 14% to \$40 million. These include market

data, exposure, account activity and FDIC bank sweep program fees; as well as fees generated from facilitating customers' participation in IPOs. Other income, which includes gains and losses on our investments and currency strategy, as well as principal transactions, was \$27 million, versus a \$59 million loss last year. Ex non-core items, Other income decreased 31% to \$11 million.

Non-interest expenses were \$317 million for the quarter, up 69% from last year. Adjusting this year for the cost of the unusual WTI event, non-interest expenses were up 13%, due primarily to higher execution and clearing costs, in line with higher trade volumes, and to higher employee compensation and benefits costs.

At quarter-end, our total headcount stood at 1,815, a 19% increase over last year. Due to the COVID-19 pandemic, most of our employees worldwide have been working remotely. After a brief pause in the first quarter, we have been hiring again to keep up with the influx of new accounts and to strengthen client services, Compliance and Systems Development for the future.

Fixed expenses were \$238 million, up 97%, primarily due to the unusual WTI event. Without it, fixed expenses were \$135 million, up 12%, driven by higher compensation and benefits, in line with the hiring that supports our growing business; as well as some increase in occupancy and G&A expenses. And, in April we donated \$5 million to assist efforts to provide food and support for people affected by the COVID-19 pandemic in the United States, as well as to advance medical solutions.

Ex the WTI loss, customer bad debt expense was \$2 million, down 50% from last year and well contained despite the dramatic increase in activity and volatility. Reported pretax income was \$222 million, down 1%, for a 41% margin. Excluding non-core items, pretax income was \$310 million, up 3%, for a 59% pretax margin. Diluted EPS were \$0.40 for the quarter, versus \$0.43 for the same period in 2019. Ex non-core items, diluted EPS were \$0.57, unchanged from last year, as adjusted.

To help investors better understand our earnings, taxes and the split between the public shareholders and the noncontrolling interests, the 2<sup>nd</sup> quarter numbers are as follows:

Starting with our unadjusted pretax income of \$222 million, we deduct \$7 million for income taxes paid by our operating companies, which are mostly foreign taxes. This leaves \$215 million, of which 81.4%, or that \$175 million reported on our income statement, is attributable to noncontrolling interests. The remaining 18.6%, or \$40 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 expense remaining taxes of \$8 million, owed on that \$40 million, the public company's net income available for common stockholders is the \$32 million you see reported on our income statement. Our income tax expense of \$15 million consists of this \$8 million plus the \$7 million of taxes paid by the operating companies.

Turning to the balance sheet, with \$8.25 billion in consolidated equity, we are well-capitalized from a regulatory standpoint. We deploy our strong capital base toward opportunities to grow our brokerage business worldwide, as well as to emphasize the strength and depth of our balance sheet to current and prospective clients and partners. We continue to carry no long-term debt.

At June 30, margin loans were \$25.7 billion, about even with last year but up 28% from March 31, as clients increased leverage over the quarter. We continue to expect swings in margin lending balances, reflecting both economic conditions and our success in attracting institutional customers, who are more opportunistic in taking on leverage. We offer the lowest margin lending rates of our competitors, and as we expand our customer base we remain well positioned to satisfy our customers' risk appetite. Now I will turn the call back over to the moderator and we will take some questions.

## **Question and Answer Session**

### **Operator**

[Operator Instructions] Our first question comes from the line of Rich Repetto from Piper Sandler.

### **Rich Repetto**

Good Evening Thomas, Paul, and Nancy. So I guess, my question -- first question is really for Paul, I think, on the net interest income. The customer credit of being a positive \$6 million, that's historically been a negative number. Can you just walk through that?

And I guess, also sort of the outlook for -- you talked about \$150 million sort of floor last quarter. Could you just talk about maybe the runoff rate or outlook for NII going forward here?

### **Paul Brody**

Sure. So, to your first question, and that's a good observation. So yes, the number was actually positive on the customer credit balances because benchmark rates have fallen so low, primarily in the U.S., that our standard credit rate to customers, which is Fed funds less 50 basis points, ordinarily a very tight spread, is now 0. So, all of those customer credits earned 0 at the moment at these benchmark rates. And there are some non-U.S. dollar currencies such -- in particular, Euro, which are at negative rates. And some of their customers get a pass-through rate, which results in a small net income on all of the currency balances.

### **Rich Repetto**

Okay. Anything on the outlook for net interest income, the roll-off of Treasurys and so forth?

**Paul Brody**

So, we're probably not far off from what Thomas indicated in the first quarter. So the second quarter, \$201 million net interest income, we have -- if rates don't change at all, we have a little ways to go in terms of the rollover of current investments that will rollover at somewhat lower rates. And our estimate is there could be another \$40 million-or-so annual reduction, but only if all the other factors stay the same. And of course, what we've seen is pretty strong growth in credit balances as we've taken on new customers and new deposits and so forth, but also quite a strong bounce back in the margin debit. There is -- people are definitely taking on leverage again. And if that continues, those numbers will be better.

**Rich Repetto**

Okay. And then last question is for Thomas. You had phenomenal account growth, great growth in margin balances and activity levels. And I guess, the question is, has that -- in really over every -- each month of the quarter, the account growth, again, just really off the map. So, could you just talk about the momentum? Is the momentum still continuing so far in July and everything that we've heard about China, has that helped in the growth of accounts sort of in Asia or Hong Kong in July to-date?

**Thomas Peterffy**

So historically, we have an account growth rate of slightly over 20%. This quarter, we had -- we saw 60%. We do not expect that to continue. I think, eventually, we're going to go back to somewhere in the low 20s. And -- but that will be on an ever-increasing base. So, the number of accounts will -- there will be more and more accounts added every quarter, more and more additional accounts, right? If you want to know what happened so far this month, only 20 days have passed, I wouldn't want to speculate about the next 10. So, watch the monthly releases, please, if you are that curious.

**Operator**

Our next question comes from the line of Craig Siegenthaler from Crédit Suisse.

**Craig Siegenthaler**

Thank you and good evening everyone. As we look at the impressive growth rates across both client equity and accounts, can you provide perspective on the contribution by geography, including Asia, beyond that 30%-plus figure that you just gave us in the prepared commentary?

**Thomas Peterffy**

So, as we said previously, geography has more rounded out in the sense that where we had experienced very high rates previously, it moderated, and where we had experienced relatively lower rates of increase, the rate has increased. So our lowest rates, geography-wise is China number one and the U.S. number two, and our highest rates are the outskirts of China and Eastern Europe, South America, Canada, et cetera.

**Craig Siegenthaler**

Thank you, Thomas. I have 1 follow-up maybe for Paul. How should we think about changes to the share count over the next year as they look at the 2% inflation number for the quarter?

**Paul Brody**

Sorry, did you say share count?

**Craig Siegenthaler**

Yes.

### **Paul Brody**

So historically, our share count has increased regularly every year as our employee stock incentive plan vests and those shares become part of the public shares. That's the primary reason. And then also, historically, there has been an opportunity for the holders of the -- what's known as the Noncontrolling Interests in the financial statements -- to effectively redeem that interest for public shares, and that has also increased the float. But as you can see, we IPO-ed in 2007 with 10%, and it's at 18% and change now. So that tells you something about the pace at which that takes place, generally.

### **Operator**

Our next question comes from the line of Will Nance from Goldman Sachs.

### **William Nance**

Hey guys, good afternoon. Maybe I'll start with one for Thomas, another one on the account growth. So can you just -- clearly, something across the world is driving a massive increase in account growth regardless of geography. So, can you just kind of talk about what is the biggest contributor to the growth? And what are the customers that you're bringing on? What do they look like compared to your average IB customer in terms of account size or activity, just to get a sense for the types of people who are kind of being brought into the market in the type of environment that we're in?

### **Thomas Peterffy**

So, the strongest growth we're experiencing is from individual customers, as you can see that our individual customers have -- now constitute -- where is my sheet? Our individual customers now constitute, I think, 55% of our accounts. And about 2 years ago, they were at 50%.

So as far as the size of the accounts, they remain relatively the same. So, what happens is that when people open an account, they open it with very little money. And then they tend to add and

add and add. So, while the average account opens, let's say, at roughly \$60,000, by the time they are with us for 2 years, they are at roughly \$200,000.

**William Nance**

Got it. That's helpful. And then maybe a follow-up on something Paul said earlier on the kind of follow-through from the impact of rates. Just a question on that \$40 million. Like the seg cash line printed about 34 basis points this quarter. I guess, maybe a more straightforward question. Where do you expect that to kind of land once we get through all of the repricing of some of your longer dated assets? And I guess, is that the primary...you printed \$40 million of interest income from that line, are you suggesting that it's going to go to 0 next quarter? Or I'm just trying to kind of contextualize that number?

**Paul Brody**

Right. So, I mean, again, depending on a number of assumptions, primarily if the rates either stay at 0 or go to 0, the U.S. rates are not effectively at 0. They have been in the 15 basis points, plus or minus, for a while. So, my number was based on all of that going to 15 basis points.

**William Nance**

Got it. So 15 basis points is kind of where you expect it to land, that's very helpful. And then maybe just a big picture one on -- I think previously, there had been something out there about you guys applying for a U.S. bank charter. Can you just kind of update where you are in the process of that? And I guess, does the lower level of rates make you rethink the client cash strategy and maybe evaluating opportunities to find kind of better sources of yield by using a bank subsidiary in the U.S.?



### **Thomas Peterffy**

So this is a long-term game, and we expect that eventually interest rates will go back up. And so, in the long-term, we definitely want to have the bank. But our immediate enthusiasm in view of the lower rates has definitely cooled. So, we are still doing it, but we are not doing it with the same rapid desire as we did it before. So, it's going forward but slower.

### **Operator**

Our next question comes from the line of Chris Allen from Compass Point.

### **Christopher Allen**

Good evening everyone. I wanted to ask a little bit on the stock lending business. Obviously, a very nice pickup. I was just wondering if there was a decent breadth to the business just in terms of a wide number of stocks or just focused on just a few? And just trying to think about how the trajectory is for that moving forward?

### **Paul Brody**

So, it's very broad based for us. We have a lot of customers, obviously, and a lot of holdings. And so there is a base of that income that tends to rise. And I say "tends to" because market conditions often determine how short customers want to be, how much risk they want to take on, et cetera. If they buy stocks on margin, they become available to be used in the securities lending market. So there is a broad base that is generally increasing for us as our customer base increases.

Having said that, as I've said before, that business is sensitive to the opportunities that come up with some well-known names that you, I'm sure, are probably following that become hot stocks from time to time, meaning that the short interest is enough and the availability is not prevalent, and so the cost of securities lending goes up. And if our customers are long and we're able to lend those shares out into the marketplace, they generate a lot more income than the run-of-the-mill stocks. So, we've spent lots of our software development efforts over the years to be able to hone our skills in taking advantage when those rates present themselves. And so that's a lot of what you see from quarter-to-quarter in terms of the opportunities, but we have -- we've built our

systems and, of course, our team to take advantage of those when they arise.

### **Christopher Allen**

And then just a quick one on expenses. I mean taking and putting aside the bad debt expense and the COVID donation, seems like most areas were in line with expectations. Employee comp, it's rising a decent amount from a year-over-year perspective. It seems like head count is on the rise though, and the typical drivers of that are kind of in place. Are you seeing any competitive pressure in terms of cost of developers? Or any other factors that you need to contemplate in terms of the expense trajectory moving forward?

### **Paul Brody**

I don't think we're seeing any particular competitive pressures. As a matter of fact, there's some evidence that since the COVID situation and work at home and the uncertainty in many industries and the layoffs and so forth, I think we've actually seen an opening up of supply, if you will, of highly qualified people. So we are taking taken advantage of that. And then, of course, we continue to build up our operations in India in client services, in software development, and we manage to find quite qualified people there, and of course, that's at a lower cost.

### **Operator**

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

### **Kyle Voigt**

Hi, thanks for taking my questions. Maybe just a follow-up on Will's earlier question on the strong new accounts and the clients. Just wondering if these new clients are more active traders or are a materially different age compared with your current client base when you compare it to kind of the clients that you had to start the year? I'm just trying to get a sense if the clients are more or less profitable than your kind of starting days of clients?

**Thomas Peterffy**

Yes. So, our average client age is -- I think it's 46. And maybe they are a couple of years younger. So, they are slightly younger. But as far as the tendency to trade, it's roughly the same.

**Kyle Voigt**

Okay. That's helpful. And then just another question on, there's a large brokerage transaction that's likely to close in the coming months in your sector. So just wondering if you see any opportunity there in terms of potentially capturing some active traders or advisers or other clients. I'm just wondering if there's any interest in increasing your marketing spend or anything to try to go after that opportunity?

**Thomas Peterffy**

Well, there are a number of RIAs who are expressing interest, who -- most of them used to have accounts with Schwab and with Ameritrade. And they are now -- since they don't want to have all their eggs in one basket, they are now beginning to inquire about having some of their accounts with us. And the second complaint, if I could call it that, is that some folks have gone from Schwab to Ameritrade and some went from Ameritrade to Schwab. And they are saying, no, I don't want to be back to where I moved away from. So -- and there is one more item, which is that some believe that Schwab is actively competing against independent RIAs by their own internal RIAs.

**Kyle Voigt**

That's interesting. So do you think -- is there a general time frame where you think that it's going to take for these RIAs to potentially start moving assets over? Or are you in the process already in opening accounts or...

**Thomas Peterffy**

It's already happening.

**Kyle Voigt**

Understood. That's good color. Thank you, Thomas. Last one for Paul is just on execution and clearing fees. I think they were down from the 1Q levels. Sorry, if I missed that. Just wondering what drove that despite the higher trading volumes.

**Paul Brody**

Well, there's always a mix of the product mix and that it's highly variable in certain products if the customer orders happen to be providing liquidity, maybe that's a lower fee, maybe even a rebate and so forth. So higher volume doesn't translate exactly into higher execution clearing costs. Volumes were up, costs are about the same this time.

**Operator**

[Operator Instructions] Our next question comes from the line of Rich Repetto from Piper Sandler.

**Richard Repetto**

Hi guys, just a follow-up here. Paul, I just wanted to clarify this, when you talked about net interest income, you said the minus \$40 million, all -- coming from seg cash, I thought you said, holding all other things being equal. So that line, I believe, only generated \$40 million to begin with, and you're saying that the rate from 34 basis points to 15, cut by a little bit more than half. So were you incorporating other things in to get to your number? Just trying to get more what you were pulling in to come up with that number.

**Paul Brody**

Well, it's primarily reinvestment at lower rates. But there's some effect coming from, say, margin loans that are still -- would have some room to come down because they're not at our best tier right? So our best -- currently, our best tier is a minimum of 75 basis points. But to the extent that some loans are being charged more than that, those would come down a bit. So it's a combination of several factors.

**Operator**

Thank you. At this time, I'm showing no further questions. I would like to turn the call back over to Nancy Stuebe for closing remarks.

**Nancy Stuebe**

Thank you, everyone, for participating today. As a reminder, this call will be available for replay on our website, and we'll be putting up 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, this concludes today's conference call. Thanks for participating. You may now disconnect.