Interactive Brokers Group (IBKR)

Q4 2016 Results - Earnings Call Transcript

January 17, 2017, 04:30 PM ET

Executives

Thomas Peterffy - Chairman and Chief Executive Officer

Paul Brody – Group CFO

Nancy Stuebe - Director of Investor Relations

Analysts

Conor Fitzgerald - Goldman Sachs

Richard Repetto - Sandler O'Neill

Chris Harris - Wells Fargo

Mac Sykes - Gabelli

Christopher Allen - Buckingham Research

Doug Mewhirter - SunTrust

Kyle Voigt - KBW

Michael Trica - Oakum Bay Capital

Rob Koehn - Ivy Lane Capital

Sean Brown - Teton Capital

Operator

Good day, ladies and gentlemen. And welcome to the Interactive Brokers Group fourth quarter financial results conference call. At this time, all participants are in a listen-only mode. Later, we’ll conduct a question-and-answer session and instructions will be given at that time. As a reminder, this conference is being recorded.

I would now like to hand the floor over to Nancy Stuebe, Director of Investor Relations. Please go ahead.

Nancy Stuebe

Thank you, operator. And welcome, everyone, to our fourth quarter earnings call. Our earnings were released after the market closed and are also available on our website. Our speakers today are Thomas Peterffy, our Chairman and CEO, and Paul Brody, our Group CFO.

We will start the call with some prepared remarks about the quarter and then we will take your questions.

As a reminder, today’s call may include forward-looking statements, which represent the company’s beliefs 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.

And now, I’d like to turn the call over to Thomas Peterffy.

Thomas Peterffy

Thank you for joining us for our final 2016 earnings conference. We finished the year with some surprises in the otherwise usually seasonally subdued holiday quarter. The results of the election surprised many investors, and people who read the New York Times and did not watch my interview on CNBC on October 3 may have mistaken its likely impact on the markets.

Kidding aside, the night and days following the election brought some welcome trading volume to the markets in an otherwise lackluster quarter.

Our pretax income for the quarter was $28 million and for the full year $761 million. Correcting for the unfavorable currency fluctuations, these would have been $181 million for the quarter and $801 million for the full year.

2016 was an unusually slow year for the markets. Aside of a few days of sudden spurts of activity following the BREXIT and the US general election votes, there was very little activity in the markets and volatility was at historic lows.

Indeed, our commission revenue declined from $617 million in 2015 to $612 million in 2016. This in spite of the number of accounts having increased by 16% to 385,000 and our customer assets increased by 27% to $85.5 billion.

Continuing with the trend of the previous years, Market Making pretax income diminished to $44 million from the previous year's $130 million, while brokerage has increased 41% from $536 million to $756 million, although the 2015 number was diminished by $140 million differentially greater bad debt expense due to the Swiss franc debacle. Without that, pretax profits from brokerage would have increased by 12%. As I said earlier, commission income decreased for the year, so that this overall income increase is mostly due to $98 million increase in interest income.

As previously indicated, this week we are introducing the so-called High Beta Portfolios, to be managed by our COVESTOR subsidiary. These are unique products, in that they combine the advantages of actively-managed mutual funds' stock selection techniques, that we have automated, with the low cost of passively-managed ETFs.

There will be five different portfolios: broad-based equity, value, growth, quality and high dividend stocks. Each stock in the portfolio will be settled in the customer's individual account and will be rebalanced automatically on a quarterly basis. Our management fee will be only 8 basis points and the associated brokerage charge should amount to no more than 3 basis points.

We are starting our marketing campaign this week. I would like to encourage you to look at the specific descriptions on our website.

This year, we set a number of new records for our brokerage business. Our clients' equity grew by 27% to over $85 billion, while our customer accounts grew 16% to 385,000. As a result of this ongoing, relentless organic growth, brokerage equity capital surpassed $4 billion in 2016 and brokerage profit of $756 million was the highest in our history so far.

Increasing brokerage profits was driven by interest income, thanks to the increased assets and higher average benchmark rates. Our customers' margin balances and carried balances moved higher, with margin loans reaching a period-end high of over $19 billion at the end of the year, as our customers capitalized on year-end trading opportunities.

The cash deposits from our customers' credit balances are invested in reverse repos, and short- and medium-term Treasury securities. This has provided a continuing stream of higher interest income as our client balance sheet grew. Last year, we had only two weeks of increased interest from the latest Fed funds rate hike.

Please remember that because at Interactive Brokers, we believe in giving investors the most powerful tools and the greatest opportunities to succeed, we will be rebating to our clients most of the future increases in interest rates. This is because the rates we pay to our customers are indexed to the benchmarks, accounts with over $100,000 of liquidating value receive interest on their cash holdings at all but half of 1% of the benchmark interest rate.

Despite two significant events in the last quarter of 2016, the US election and the Federal Reserve increase in target interest rates, overall volatility remained very low. In our brokerage business, we saw growth in all five different client types that we service. I will go over our five different client segments.

We saw particular strength in our introducing broker segment, which had 2016 account growth of 33% and client equity growth of 53%. As the operating and especially regulatory costs of running the brokerage firm continue to increase, small and mid-size brokers who find it difficult to justify managing their own technology have been coming to us to white label our state-of-the-art technology and capitalize on our lower costs.

We are pleased to welcome Zions Bank as an introducing broker customer. They have begun migrating their accounts over to us, and will continue to do so over the coming weeks and months. This will add about 6,000 accounts and up to $2 billion of client equity to our existing base.

We think this is a beginning of a larger trend, even more so in Europe and Asia than in the United States. Because we are fully automated, our costs are very low and we charge very little, making it much less expensive for a broker to come to our turnkey system than maintaining their own.

The introducing broker does the customer service and manages the relationship with the clients. We provide the trading, clearing, custody, and regulatory infrastructure. We have captured a tiny fraction of what we believe is perhaps a $1 trillion market, and we have much more room to grow here. We are seeing new brokerage firms popping up all over the world as new businesses, to take advantage of our offering.

We recognize that many may fail, but some will almost certainly succeed and become wonderful partners to us. This is especially true in countries in Eastern Europe and Asia where investing is a relatively new concept and, to a lesser extent, in South America. Because we offer value that is most obvious to active clients, we have a high concentration of active traders among our customers.

As we grow our customer base, we are naturally recruiting customers who, on average, trade less frequently. Our success in recruiting introducing brokers emphasizes this point. Because while highly profitable for IB, introducing brokers tend to have lots of accounts who do not trade as frequently. As a result, our average customer account transacted 400 times last year, compared to 450 in the preceding year. Or to illustrate the point in another way, while the average introducing broker customer spent $463 in commissions, the average direct individual customer spent more than three times that much or $1,437 in commissions.

Second, hedge funds. We saw good growth in the hedge fund customer segment. This group is 1% of our accounts, 9% of our client equity and 9% of our commissions. For the year, we saw 13% hedge fund account growth, 29% customer equity growth, and positive commission growth of 7%.

As big banks in both the US and internationally look to preserve their balance sheets, they are asking the smaller, less profitable hedge clients to leave. Barclays and Deutsche Bank made announcements to this effect in this past quarter. This encourages more potential hedge fund clients to try Interactive Brokers, see the quality of our platform, evaluate the strength of our balance sheet, and ask themselves why did they not come to Interactive Brokers sooner.

Hedge funds are a large multi-trillion-dollar global market and we have tremendous room to grow in this area.

Thirdly, individual customers, which make up 56% of our accounts and 37% of our client equity and 51% of our commissions, saw account growth of 13% for the year, while client equity 24%, but commissions were unchanged.

The slow trading environment meant that commissions for these customers were flat for the year. We have opportunities to grow our customer base in this segment. We are looking at ways of making it easier for individuals to learn our platform. As an example, last year, we started to produce short videos that explain different parts of our offering.

Number four is proprietary trading firms that represent 3% of our accounts, 13% of client equity and 17% of commission. For the year, this group grew 10% in accounts, 18% in customer equity. However, because prop traders are the customers most sensitive to the lack of volatility in the current trading environment, their commissions were down by 8% versus last year.

We are well-penetrated in this segment, so while we expect some growth, it will not represent our largest customer development opportunity.

Fifth and final category is financial advisors. They are 19% of our accounts, 26% of our customer equity and 17% of our commissions. This group grew accounts by 14% and customer equity by 21%. However, the slow trading environment led to a 4% decrease in commissions.

We focused this year on making it even more seamless for registered financial advisors to achieve their independence, with the launch of Greenwich Advisor Compliance Services. Greenwich Compliance provides registration and compliance assistance for a new or existing RIA business. Going independent means RIAs can keep all the fees they earn. Given the increase in advisors looking to become independent, our low commission and financing rates and our Greenwich Compliance assistance, we believe we have the right formula for continued growth in this segment. Globally, investment advisors have about $20 trillion in AUM, so we have plenty of opportunity in this area.

We look forward to the upcoming quarters. We are dedicated to continually introducing new capabilities and improving the power, control and customization of our platform for our customers. If you are not already a customer, try our free demo. Look for the launch of our new more powerful Portfolio Analyst tools.

And at this point, if I had to guess, I would say that our Market Making business will not improve in the coming year, but the brokerage business will continue to grow at a rate in the high teens, although we will certainly try for more. We have a practically unlimited runway in front of us.

And with that, I will turn the call over to our CFO, Paul Brody.

Paul Brody

Thank you, Thomas. Thanks, everyone, for joining the call. I'll start with our summary results and then move on to segment highlights before we open it up to questions.

The fourth-quarter operating results reflected a solid performance in Brokerage, led by gains in net interest income and a positive swing in mark-to-market value of investments on US government securities versus the prior year quarter. These were largely offset by currency translation losses and lower earnings in the Market Making segment.

Full-year results showed strength in core brokerage and continued decline in Market Making. Our pretax income of $761 million represented a return on average equity of 13% and a profit margin of 55%. Excluding currency translation effects and Treasury marks, our profits were $775 million with a similar pretax margin.

Overall operating metrics reflected a somewhat better trading environment, but still sluggish market volatility. While we saw an increase in activity around the US presidential election in November, the subsequent decline in December activity led to quarterly total DARTs at about 3% below the average for the year.

Average overall daily trade volume for the quarter was 1.32 million trades per day, even with the fourth quarter of 2015 and up 5% sequentially as the average VIX level declined 18% and rose 6% respectively over the same time period.

We continued to see strength this quarter in asset gathering and margin balances and brokerage as I'll describe in my comments on that segment's performance. Electronic Brokerage metrics showed solid increases in the number of customer accounts and customer equity, up 16% and 27% respectively. Total and cleared customer DARTs were unchanged and up 2%, respectively, from the year-ago quarter even in the face of low volatility.

Orders from cleared customers who clear and carry their positions in cash with us and contribute more revenue held steady at 92% of total DARTs this quarter. Market Making contract and share volumes were down across product types.

Fourth-quarter net revenues declined 29% versus last year, while pretax income was down 78% for a pretax margin of 15%. Excluding our Treasury marks and currency translation effects, net revenues were up 4% versus last year, while pretax income was down 3% for a pretax margin of 54%.

Our Brokerage results were boosted somewhat by strong gains in customer accounts and equity, while low volatility and a decline in volumes continued to impact the market maker.

Other market factors had the following impact. First, we saw continued low market volatility. The average VIX fell 18% year-over-year. And to bring some historical perspective to this, only six quarters in the last ten years have exhibited a lower average VIX. Actual to implied volatility fell 29% from the prior year quarter. And generally, a low VIX dampens trading volume and, therefore, Brokerage revenues, while both measures affect our Market Making business.

While we saw increased activity around the US election in November, in December volatility returned to the low levels we experienced during the summer. Except for this brief opportunity, we continued to see fewer opportunities for our Market Making business.

Next, the US dollar strengthened markedly in the fourth quarter versus other major currencies. As a result, the currency basket in which we keep our equity, which we call the GLOBAL, fell 3.4% against the dollar for the quarter. This resulted in a loss of $201 million which includes a loss of $153 million reported in Other Income and a loss of $48 million in Other Comprehensive Income or OCI. We estimate the total impact to earnings per share from the GLOBAL to be a loss of $0.35 for the quarter with $0.24 reported as other income and $0.11 as OCI.

And for the full year, the US dollar strengthened 0.9% relative to other major currencies, resulting in a loss of $65 million, which includes a loss of $40 million reported in other income and a loss of $25 million in OCI. We estimate the total impact to full-year earnings per share from the GLOBAL to be a loss of $0.13, with $0.07 reported as other income and $0.06 as OCI.

Finally, medium-term interest rates rose in the quarter as the Federal Reserve followed through on its expected target rate increase of 25 basis points. As a result, mark-to-market losses on our

Treasury portfolio were $11 million. Although we plan to hold these securities to maturity, we must, as brokers, unlike banks, mark them to market quarterly.

Net revenues are $193 million for the quarter, down 29% on a reported basis from the year-ago quarter. Several factors that fall outside our core operating activities should be considered in comparing the current quarter's revenues to the prior year's.

First, our currency strategy caused a loss of $153 million versus a loss of $19 million in the year-ago quarter. And the Treasury portfolio marks-to-market deducted $11 million from our revenues in the current quarter, compared to a loss of $52 million in the year-ago quarter.

And so, adjusting for these two factors, on a pro forma basis, our total net revenues would be $357 million in the current quarter and $342 million in the year-ago quarter, or up 4%. This core increase was driven primarily by strength in our Electronic Brokerage segment, somewhat offset by lower trading gains in our Market Making business.

Increases in commissions, and especially net interest income, plus a significant improvement in our Treasury portfolio performance versus the fourth quarter of 2015, were the drivers in our Electronic Brokerage segment this quarter. Commissions and execution fees were $150 million, up 4%. And interest income was $138 million, up 17%. Brokerage produced $129 million and Market Making $6 million, with the remainder in Corporate. Since the Federal Reserve rate hike took effect in December, we expect most of the benefit of this increase to be reflected in our numbers going forward.

Trading gains were $39 million, down 26% from the year-ago quarter. With the continuation of low volatility, our market maker has had fewer opportunities for trading.

Other income, which as I described earlier includes the effects of our currency diversification strategy and Treasury portfolio marks, was a loss of $134 million versus a loss of $44 million in the prior-year quarter.

Non-interest expenses were $165 million for the quarter, up 15% from the same quarter last year. The rise reflects specific increases in fixed expense categories, in particular, software development, legal and compliance costs. Generally, we continue to closely manage our expenses as we selectively build our capabilities in growth areas.

At December 31, 2016, our total headcount stood at 1,204, an increase of 11% over the prior year-end count and up 1% sequentially. We have continued to expand in a few key areas, notably customer service, legal and compliance, and software development, all of which support the growing brokerage business.

Our reported pretax income this quarter was $28 million, leading to a 15% pretax margin. However, excluding non-core items, our pretax margin – our pretax income would have been $192 million for a 54% pretax margin. This compares with fourth quarter 2015 adjusted pretax income of $197 million for a 58% margin, net of the same factors.

Brokerage pretax margin was a reported 57% as compared to 52% last year. And adjusted for non-core items, brokerage pretax profit margin was 59% versus 61% in the prior year quarter. And Market Making pretax profit margin was 27% versus 39% last year.

And for the full year 2016, we earned pretax income of $761 million on net revenues of $1.4 billion versus $458 million on $1.2 billion of net revenues in 2015. Excluding non-core items, our pretax income would have been $775 million, for a 55% pretax margin. This compares with full-year 2015 adjusted pretax income of $816 million, for a 58% pretax margin on the same basis.

Comprehensive diluted earnings per share were a loss of $0.05 for the quarter as compared to a gain of $0.18 for the fourth quarter of 2015. And on a non-comprehensive basis, which excludes OCI, diluted earnings per share on net income were $0.07 for the quarter as compared to $0.25 for the same period in 2015.

Excluding the impact of non-core items, comprehensive diluted earnings per share were $0.32 for the current quarter, versus $0.36 for the year-ago quarter on the same basis. And for the full year 2016, comprehensive diluted earnings per share were $1.19 versus $0.62 in 2015. On a non-comprehensive basis, excluding OCI, diluted earnings per share on net income were $1.25 versus $0.78 in 2015.

Excluding non-core items, full-year comprehensive diluted earnings per share were $1.29 for 2016 versus $1.37 for 2015 on the same basis.

Turning to the balance sheet, as a result of the growth of our Brokerage business and the withdrawal of capital from our Market Making operations through regular and special dividends, Brokerage now accounts for about 81% of our combined balance sheet assets from the two segments and 70% of the consolidated equity.

Our balance sheet remains highly liquid with low leverage. We actively manage our excess liquidity, and we maintain significant borrowing facilities through the securities lending markets and with banks.

As a general practice, we hold an amount of cash on hand that provides us with a buffer should we need immediately available funds for any reason. At December 31, we maintained over $4 billion in excess regulatory capital in our broker-dealer companies around the world, of which about 78% is in the brokerage segment.

We continue to carry no long-term debt and our consolidated equity capital at December 31, 2016, was $5.8 billion, of which approximately $4.1 billion was held in Brokerage, $1.5 billion in Market Making, and the remainder in the corporate segment.

Turning then to the segments, we will begin with Electronic Brokerage. This quarter, we saw a rise in stock volume, largely driven by increased trading in low-priced stocks in US, Hong Kong and Australia versus the prior-year quarter. Customer trade volumes were higher in futures and stocks and lower in options.

While cleared customer DARTs rose 2% over the prior-year quarter, cleared customer volume was mixed, with options contracts falling 1% and futures and stock share volumes rising 5% and 27% respectively from the year-ago quarter.

Foreign exchange volume was off 8% from the year-ago quarter, contributing factors were the overall contraction in the retail FX market, as well as our policy change which took effect around September 1, limiting customers with less than $10 million in assets from making FX trades using leverage. We adopted this limitation due to a lack of clarity on the regulation of retail FX business in the United States. However, the impact on our overall FX volume was not substantial.

Commission revenue rose 5% on a product mix that featured smaller average trade sizes in options, slightly larger in futures, and substantially larger in stocks. This mix resulted in an overall average cleared commission per DART of $4.01 for the quarter, up 5% from the year-ago quarter and up 3% sequentially.

For the full year, commission revenues were down less than 1%, while net interest income rose $98 million or 25% to $498 million. Customer equity grew to $85.5 billion, up 27% from last year. The source of this growth continues to be a strong inflow of new accounts and customer assets.

We continue to attract larger customers along with financial advisors and introducing brokers that manage groups of smaller accounts, all of which results in a blend that affects both average trade size and average account equity. Our average account equity rose 9% year-on-year to $222,000. And in addition to the larger accounts that we're attracting, part of this growth was fueled by new services to targeted customer types, including our Greenwich Advisor Compliance Services for RIAs and new services we have made available to administrators of employee stock plans in which we can act as broker first to the administrator's issuer client and later directly to the employee participants. To the extent we're successful, we would expect these client segments to produce more commission revenues with some lag time.

Margin debits rose 14% year-over-year, reaching a record level of $19.4 billion. Customers' appetite for increased risk, along with our expanded prime broker financing, were responsible for this increase. Customer credit balances continued their steady growth, rising 13% over the year-ago quarter.

Net interest income rose to $129 million, up 25% from the fourth quarter of 2015. For the full year, net interest income rose to $498 million, up 25% from 2015, representing now 40% of net revenues as compared to 36% in the prior-year.

The Federal Reserve's increase in the federal funds target rate this past December, together with increased customer balances, has generated more net interest income on cash balances.

Our continued success in asset gathering sets the stage for larger revenue contributions from interest-sensitive assets going forward. And our Stock Yield Enhancement Program, where we share revenues from lending out fully-paid securities with our customers, continues to provide an additional source of interest revenue on securities assets. In addition, we continue to improve our securities lending utilization to capture more revenue from lending hard-to-borrow stocks.

With a growing customer asset base, we continue to believe we're well-positioned to prudently maximize our net interest income, given the opportunities presented by the market.

Based on current balances, we estimate that a general rise in overnight interest rates of another 25 basis points would produce an additional $41 million in net interest income annually. Further increases in rates would have a smaller impact because the interest we pay to our customers is pegged to benchmark rates, less a narrow spread.

Fixed expenses in brokerage were $80 million, up 14% over the year-ago quarter and 4% sequentially. The primary component of this increase was higher compensation costs, particularly related to software development. We expect software development compensation and the securities industry regulatory burden to continue growing, but we believe our focus on applying technology to compliance and regulation will keep our costs of compliance lower than our competitors.

Customer bad debt expense was negligible this quarter, down from $1 million in the year-ago quarter and $3 million sequentially. Our Risk Committee continues to enhance our scenario-based risk models in order to reduce exposures to world events.

Pretax income from Electronic Brokerage was $168 million, up from $113 million in the fourth quarter last year. Excluding Treasury marks, core pretax income was $179 million, up from $164 million last year for a 59% pretax margin.

Turning to Market Making, trade volume declined year-over-year across all product types. Options and futures contract volumes fell 10% and 14% respectively, while stock share volume was down 39%. As in brokerage, a substantial portion of the drop in stock volume came from low-priced stocks trading in Hong Kong.

Trading gains from Market Making for the fourth quarter were $39 million, down 26% from the year-ago quarter, but up 3% from the third quarter. Market volatility measures were significantly lower than a year-ago. And other than the US presidential election which produced a few active days, there was a dearth of market events in the latest quarter that presented us with profit opportunities.

Pretax income was $12 million in the quarter, down from $27 million last year. And for the full-year, pretax income was $44 million versus $130 million last year.

On the cost side, execution and clearing fees expenses were down 22%, in line with lower trading volume. Fixed expenses decreased to $19 million, down 21% from the year-ago quarter as we continue to pare down the cost of running this business.

Looking at the Corporate segment, the earnings reported for this segment reflect the effects of our currency diversification strategy. Our overall equity, as measured in US dollars, was decreased by the strengthening of the US dollar against all other major currencies. We estimate the overall loss from our strategy of carrying our equity in proportion to the GLOBAL to be about $201 million for the fourth quarter of 2016. As I described, because $48 million of the GLOBAL loss is reported as other comprehensive income, this leaves a loss of $153 million to be included in reported earnings.

And for the full year, the overall loss from our strategy of carrying our equity in proportion of GLOBAL was $65 million with $25 million reported as OCI, leaving $40 million to be included in reported earnings.

And as a reminder, at the end of the second quarter of 2016, we made some modest changes to the composition of the GLOBAL, as we reported at that time, and those changes are reflected in our results for the second half of 2016.

Now, I'll turn the call back over to the moderator and we will take some questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question comes from the line of Conor Fitzgerald from Goldman Sachs.

Conor Fitzgerald

Good evening. A couple on your net interest income. I guess, leaving rates aside for a moment, you mentioned growing your stock lending business, can you help us get a sense of how much additional net interest income upside there is for you as you continue to kind of grow that part of your business?

Paul Brody

I’m not sure we could quantify it looking forward, but it certainly grows in line with the growth of our balances naturally. To the extent that we’re successful in attracting more professional customers, more hedge funds, they seem to have an interest in the short side of the market, more than individuals. And so, to the extent that we can better our services there, so that that portion of interest revenue will thrive along with that part of the business. And we’re being pretty successful in that lately.

Conor Fitzgerald

And then, Paul, I think I heard you say $45 million from the next Fed hike. I just wanted to clarify that. Not what the Fed did in September, but prospectively another 25 basis points higher.

Paul Brody

Right. With the next 25 basis point move, we would expect in the numbers $41 million, in terms of interest rate sensitivity. As I said, further increases would produce smaller results because once we're into positive rate territory, which we now are, the interest spread is locked in. We give a very narrow spread to our customers on both the debit and credit side. And so, we would benefit on smaller balances and on things like short stock borrow opportunities. But other than that, it would basically rise with the rising balances.

Conor Fitzgerald

Okay. I thought that your pricing model was 50 basis points of Fed funds; after that, you started sharing with the client. So, I just – the $41 million was a little higher than, I think, I and a couple of others would have guessed. So, I wanted to understand, I guess, why the Fed going up to, whatever, 90 basis points just was more asset sensitive than kind of 90 to 115, but that makes sense.

And then on the employee compensation, I think you’ve mentioned some of the compliance costs coming in, are those fully in the run rate at this point?

Paul Brody

I'm not sure we can answer that question. As our business grows, we add on different kinds of legal and compliance support services. So, we now have an entity called Greenwich Advisor Compliance Services, as Thomas mentioned. And these costs go into revenue-producing activities. They’re not all in the background. So, there's a mix. I’m not sure any of us know what the regulatory environment holds for us going forward. So, it’s some combination of expanding the size and complexity of the business, and the regulatory environment in general.

Thomas Peterffy

Conor, I said in my part that we do not pay interest to accounts with liquidating values under $100,000. And quite a few of our accounts are in that category.

Conor Fitzgerald

That’s helpful. I think what I was just trying to understand is why that $41 million would then go to some de minimis amount if you're presumably not paying interest through the cycle on those smaller clients. But I’m just trying to understand why it goes to $41 million, and so that’s down to something de minimis and why it’s not more sustainable.

Thomas Peterffy

Well, because it’s not de minimis. There is a very substantial amount of money in those accounts.

Conor Fitzgerald

That’s helpful. Thank you.

Operator

Thank you. And our next question comes from the line of Rich Repetto from Sandler O’Neill.

Richard Repetto

Yeah. Good evening, Thomas. Good evening, Paul. I just want to follow up on the comp question here a bit because it’s just – I know you've been adding people in the areas that you talked about, Paul, but if you look at the quarterly comp for the year, it was – the first three quarters at $58 million and then you jump up $10 million in the fourth quarter. And I thought you said the headcount didn't really – it was only a single-digit percentage, I thought, quarter-to-quarter. I guess the question is why the step up in comp in 4Q.

Thomas Peterffy

The reason is bonuses, actually. Bonuses.

Paul Brody

So, most of it’s accrued, and then sometimes we have adjustments to true-up to actual at the end of the year.

Thomas Peterffy

So we paid higher bonuses than we accrued.

Paul Brody

Right.

Richard Repetto

Okay. Because I'm looking back at prior years and that hasn't been a trend in the fourth quarter except for this year. Anyway…

Thomas Peterffy

It’s a very competitive world.

Richard Repetto

Okay. Okay. The next question is, on the net interest income, Paul, it was pretty flat quarter to quarter. And the balances, it looked like they grew either high-single-digit –more than what you would guess. So, I guess, was there – I’m just trying to see how you didn’t – realize a bigger increase in net interest income, given the growth in the balances quarter-over-quarter.

Paul Brody

You mean sequential quarters?

Richard Repetto

Yes.

Paul Brody

Not versus the prior year?

Richard Repetto

Right, correct.

Paul Brody

Right, right. So, we had a 7% sequential increase in debit balances. Credits were roughly kind of flat. In fact, down very slightly. And sequentially, we had a 1% increase in net interest. Understand, partly – there's a couple of effects here. One is that larger customers are going to get the best rates, meaning the smallest spread to us. That's one effect. We're happy to take in that business. It's just perhaps incrementally at a smaller spread. And there are sometimes extra costs around – at end of period, especially around end of year when markets tighten up and things like the foreign currencies – and there are a number of currencies that are in negative interest-rate territory, like the Euro. And to the extent that we don't pass on all of that cost to our customers, we absorb some of that.

Richard Repetto

Okay. I guess, the last question, Thomas, is – and you sort of talked about this in the prepared remarks. But you got the agreement with Zions, and you got more potential there to do this other banks and brokers, I suspect. And, I guess, the question is, will the incremental customer that you're getting from these introducing brokers or – and even these banks where you have the sort of the relationship with – like, will you get the same customer that has a level of trading activity that you've been accustomed to in the past, I guess is the question. It seems like you're growing…

Thomas Peterffy

As I said, introducing broker customers are yielding us roughly half as much as regular customers do, all in. So, the commission they generate is about a third or maybe even less – they may be even less than that. Interest income is also less, but not that much less.

Richard Repetto

Okay. Okay. That's helpful. Thank you. I'll get back in the queue if there are, I guess, more questions. Thanks.

Operator

Thank you. And our next question comes from the line of Chris Harris from Wells Fargo.

Chris Harris

Thank you. I want to follow up on that last question regarding the introducing broker relationships. Do you guys handle all the customer service requests for those relationships as well?

Thomas Peterffy

No. No, no. The customer service is done by the introducing broker.

Chris Harris

Got you, okay. I wanted to ask you sort of a hypothetical here, it might be hard to answer, but really wanted to talk to you a bit about tax reform here in the US. I imagine your taxes are a little bit more complicated than some of your peers. I think with some of the peers in the industry, we can just say, well, if there's a 10% reduction in corporate tax rates, maybe that flows through exactly the same in the P&L. What do you think is going to be the impact on IBKR's P&L if we do see a lowering of the corporate tax rate by, say, 10%?

Thomas Peterffy

Paul?

Paul Brody

Well, obviously…

Thomas Peterffy

I told you that you're going to get this question.

Paul Brody

Oh, yeah. Sure. No, I thought that you would respond. So, our taxes are – you are right. It's not as simple as an individual. They fall into several streams, sort of. There are taxes paid via our foreign affiliates and that won't change. To the extent it then flows on through to the US and then on to our IBKR, the public company, that portion will, obviously, benefit from the lower tax rate. The other effect, as you've seen probably some things written about, especially with some of the big banks, is that they have large deferred tax assets. We have a deferred tax asset that results from the structure that we created during the IPO. It's a reflection of tax benefits to be gained, over time, in the future. So, to the extent that rates go down, the estimated value of that deferred tax asset as well goes down, and accounting convention requires the firms take a write-down all at once. Our estimates show that it's not going to have a big material impact on us, the way it would on some of the larger banks that have been written about. But on an operating basis, obviously, the portion that flows through the public company will benefit from the lower tax rate.

Thomas Peterffy

So, if they cut our tax rate by a half, our income would rise by how much?

Paul Brody

I can't give specific numbers at this time. But we could try to put those out at another time. We have not done all the analysis on that.

Chris Harris

Okay. Thank you, guys.

Operator

Thank you. And our next question comes from the line of Mac Sykes from Gabelli.

Mac Sykes

Just to jump on Chris' question. In terms of the actual makeup of the firm, owning that it's public-private, have there been any talks in terms of some of the taxes for the partnership stuff causing any thoughts on maybe changing the structure of the overall entity?

Thomas Peterffy

No, we're not thinking about changing the structure.

Mac Sykes

Okay. And then, what is driving the hedge fund lending? Is it overall desire for leverage, a closer focus on your competitive spread rates or active efforts by your sales people? I was just curious if we could dig into that a little bit more.

Thomas Peterffy

Well, they are all those, but, obviously, our sales force is a driving force. But one of the things that we do is we display our short availability and the rate at which our lending – that we would charge for lending those shares. And hedge funds can come to us and look it up online. And they do come to us and they look it up online and then they go back and beat up their prime brokers and say, how come Interactive Brokers is lending at that and you're charging me this? The prime brokers usually succumb, except when the hedge fund is small and they say, well, we don't care, go to Interactive Brokers.

Mac Sykes

And then my last question, on Treasury management, now that balances are pretty significant. Have you ever considered maybe starting a bank or perhaps like…?

Thomas Peterffy

Yeah, but we don't want to take on the hassle. So, you see, we are a global broker and that goes with a lot of hassle, a lot of regulations. So, that is where we want to have our competitive fight, because we have relatively little competition on that because there are very few folks who do direct access brokerage globally. And so, that's where our focus is.

Mac Sykes

Great. Thanks for taking my question.

Operator

Thank you. And our next question comes from the line of Chris Allen from Buckingham.

Christopher Allen

Good afternoon, guys. Thomas, if I heard you correctly, you talked about no growth – the outlook for no growth in Market Making, but double digit growth in…

Thomas Peterffy

Speak into the phone please.

Christopher Allen

I'm sorry. Can you hear me?

Thomas Peterffy

Barely.

Christopher Allen

Is that better?

Thomas Peterffy

Yeah, much better.

Christopher Allen

Just the outlook for growth moving forward, you're not expecting Market Making to grow, but you're expecting Electronic Brokerage to grow double digits. Are you referring to the outlook for revenue growth or more accounts and customer equity growth? Any color there would be helpful.

Thomas Peterffy

All of the above.

Christopher Allen

And does that – for the revenue growth outlook, does that bake in a better environment from a volatility perspective?

Thomas Peterffy

No, no, no. It's going to grow because our number of accounts are growing and our customer equity is growing. So, that is how it's going to grow.

Christopher Allen

Got it. Okay. And then, I guess just a quick question on the Treasury marks, $11 million, that was about $0.02 in EPS impact, is that correct, Paul?

Paul Brody

For what time period? The quarter or the year?

Christopher Allen

The fourth quarter. Just the fourth quarter.

Paul Brody

The Treasury marks are about $0.02, yes.

Christopher Allen

Okay. Thanks a lot, guys.

Operator

Thank you. And our next question comes from the line of Kyle Voigt from KBW.

Kyle Voigt

Hi. Good afternoon. Just on the Greenwich Advisor Compliance Services, I think you started the rollout of this subsidiary in the third quarter. I just wanted to get an update here. Are you still adding significant functionality in headcount? And then, can you give us any indication as to whether you're seeing more interest from FAs they are on-boarding or any feedback from the advisor community on the early rollout?

Thomas Peterffy

Yeah. So, the early rollout is very encouraging. Yes, we are definitely focusing on adding more capabilities and we have regularly – especially, registered investment advisors who had previously worked for the bulge bracket brokers, tend to come and ask about going independent and how they should do that.

Christopher Allen

Okay, thank you. Just one for Paul. Just to follow up on the comp expense again. Is there any way you can quantify, I guess, the true-up on the bonus comp in the quarter? Just trying to get a sense for the right run rate there going forward?

Paul Brody

We don't have specific numbers on the true-up. However, if you looked at the annual, I think that's probably your accurate – is as accurate as you can get on the run rate.

Christopher Allen

Okay. Thanks for taking my question.

Operator

Thank you. And our next question comes from the line of Michael Trica from Oakum Bay Capital.

Michael Trica

Good evening, guys. This is a question for, I think, Thomas, from the perspective of not only an investor, but a pretty active client as well. I had a question about the level and degree of iteration on improvements or changes on the TWS platform. Candidly, we've kind of experienced some latency in improvements and would even suggest maybe forming a roundtable of clients – larger clients, active clients of TWS of Interactive Brokers - to better communicate potential changes and speed up the iterations of those changes.

Thomas Peterffy

We would be happy to do that.

Michael Trica

And certainly, we would love to participate.

Thomas Peterffy

Great. Good. That’s a good idea. But you are saying that you had experienced latency or it was – it is – is it getting better or worse?

Michael Trica

Just the – we've been customers for – on and off for about a decade. And just the process of suggesting changes, I believe it's writing a ticket. And in terms of what we've done in the past, we've written tickets and not heard responses for weeks, small changes on TWS.

Thomas Peterffy

Address it to me and I tell you, you will get a response.

Michael Trica

Certainly, I would gather a round table of large investors or large clients…

Thomas Peterffy

Yeah. That’s a great idea. We will do that. Thank you very much.

Michael Trica

Thanks for your time.

Operator

Thank you. And our next question comes from the line of Doug Mewhirter from SunTrust.

Doug Mewhirter

Hi, good evening. Just had a question on the market maker. You talked about how you're looking for alternatives for it if you can't fix it. Of course, you're not in the best market right now with volatility being so low. Do you have the same general, I guess, plan? I know there's a lot of different options, joint ventures or sales. Are you leaning one way or another if that contingency has to happen?

Thomas Peterffy

We're continuing to explore different possibilities for the market maker, yes.

Doug Mewhirter

Okay. And your commission per DART went up sequentially fairly nicely. I assume it was the business mix. Was there any unusual – I know that the futures volumes spiked with the election. Is that something that you think you could maintain going into this quarter and this year or is the business mix – or is the business mix going to sort of go back to a normal historical level?

Thomas Peterffy

It depends on the business mix. To the extent we get more hedge funds and large customers, our commissions per DART will go up. To the extent we get more introducing brokers, our commissions will go down. I mean, that's commission per DART.

Doug Mewhirter

Okay. That's helpful. Thanks. That's all my questions.

Operator

Thank you. And our next question comes from the line of Rob Koehn from Ivy Lane Capital.

Rob Koehn

Hey, thanks for taking my question. So first, to follow up on Conor's question on a future Fed funds hike, so with the next Fed funds hike, Paul, of 25 bps, you cited $41 million. So, given that interest income is generated three or four different ways, say there was a second hike. Is that maybe a different way of asking the question? How much net interest income increment would we expect from a second hike of 25 bps? Would it be $35 million? Would it be…?

Paul Brody

So, we actually looked at those two scenarios to come up with the $41 million. If they were two sequential 25 basis point increases – in other words, two sequential and then stay flat for the rest of the year, the number would be about $47 million.

Rob Koehn

Okay, okay.

Paul Brody

And that takes into account the component. In other words, our tiered schedule of paying interest and charging interest and the maturity schedule on our investments and so forth.

Rob Koehn

Okay, okay. And then on the Electronic Brokerage for Q4, to make sure I have my numbers right, the reported net revenue of $294 million, if you exclude the $11 million of Treasury mark-to-market hit, that becomes $305 million net revenue?

Paul Brody

Yeah, that’s right.

Rob Koehn

And therefore, that would flow – all of that would flow down to brokerage pretax. So, or $168 million would become $179 million?

Paul Brody

Yes.

Rob Koehn

And so, the margin would be 59% instead of the 57% that's listed?

Paul Brody

The margin would be 59%, right.

Rob Koehn

Okay. Great. And I understand that there – the auditors probably don't make it easy for you to put out a pro forma table, and I know somebody's asked this before. But I do think that one of the biggest challenges here is the fact that these are extremely confusing quarterly reports between the GLOBAL marks and the Treasury marks, being a brokerage instead of being a bank. And there's not much you can do about that. But if there's any way to make this more clear, I think that would be helpful to everybody involved.

Thomas Peterffy

What we’ll do is, we just decided that – at each month end, along with our brokerage metrics, we will publish the change in the GLOBAL for the month and the quarter-to-date and year-to-date, so we’ll always know what the number is. If you like, along with that, we could also publish the Treasury marks. Everybody should understand that the reason why we have these marks is that we are not – we must mark them to market, but at the end it all becomes just part of the interest income.

Operator

Thank you. And our next question comes from the line of Sean Brown from Teton Capital.

Sean Brown

Hi, guys. I have just one quick question around the individual account business vertical. And it's around IRAs, in particular. I see that, I guess, two weeks ago, you've insourced the IRA custodian business. I think that was outsourced before and customers had to kind of pay an extra fee, and now it's going away. Is this a big market space for the long term or…?

Thomas Peterffy

I don’t know what you just said. What did you just say? Two weeks ago, what happened?

Sean Brown

On January 1 – I think, yeah, Interactive Brokers insourced the IRA, individual retirement account custody.

Thomas Peterffy

Insourced?

Sean Brown

Yes. That’s right.

Paul Brody

It’s primarily a fiduciary and reporting function that we did take in-house. It's not something that we would expect to turn into a business line to do for others. We plan to do it. Our plan right now is we’re doing our own IRA custodian and reporting function for our own customers. I think that's what you're asking about.

Sean Brown

Right, right. And it seemed that as you've presumably built out internal capabilities for that and some automation in the systems around that, maybe that is a business line that could be poised for growth, just on an organic basis. Would that be correct? Or is this just not a big enough market to grow for the long term?

Paul Brody

Well, I think, if anything, we might look at it along the lines of when we build automation for compliance services, in general, we think that that attracts certain types of customers. It makes them sticky customers because we can perform those compliance activities for them and they might be brokers. And I suppose this could turn into one of those. But we’ve got to get it right on our own first, and this is our first leg in.

Sean Brown

Got it. So, for now, I should think of it as more of a cross-sale to our existing individual customer base; and then later on, it could be an attractive capability to the potential Introducing Broker customers?

Paul Brody

I wouldn't call it a cross-sell because it's a transparent function to the customer. The customer just wants his custodian function and his reporting done on an annual basis. In the background, it's now being done in-house at IB.

Sean Brown

Right, right. But due to the $30 per year fee that was passed on to the customer previously, I'm guessing there were a lot of Interactive Brokers customers who had just created their IRA at Vanguard or ETRADE or Fidelity, somewhere that didn't have a fee previously, even if they had an individual broker account or margin account at IB.

Paul Brody

I'm not sure what other brokers charge in terms of administration fees for IRAs. However, small IRAs are not of great interest to us. They don't tend to trade a lot. They're retirement accounts. They often are threshold accounts, so that it allows introducing brokers or financial advisors to bring on a whole group of accounts over to us if we can support the IRA portion of those accounts. We have been doing that for a number of years and now we've improved on the process.

Sean Brown

Got it. Got it. Thank you.

Operator

Thank you. And we have time for one more question. Our final question for today is a follow-up from the line of Rich Repetto from Sandler O'Neill.

Richard Repetto

My question has been asked and answered. Thank you.

Operator

Thank you. And we would now like to take a question from the line of Rob Koehn from Ivy Lane Capital.

Rob Koehn

Thank you. Just one follow-up. So, on Introducing Brokers, can you – Paul, can you quantify a contribution margin? Since you're not providing customer service to these introducing broker customers, even though they're generally at a lower commission rate because they're on the grid. Is that still like a nearly a 90% or 95% contribution margin type of business then?

Paul Brody

Thomas, do you want to respond?

Thomas Peterffy

It’s very hard to tell. So, our customer service is still being used by the introducing broker himself up until his people are well trained. And that takes quite a long time. And then our expenses as far as customer service, it’s not a major part of our – it’s not the majority of our expenses. So, to the extent the – at a later stage in the life of an account, that expense is no longer imputable - it’s very hard to guess.

Rob Koehn

Right. It's a theoretical question. Okay. But, presumably, you've done the math and you're comfortable that it's still a very profitable business at any rate.

Thomas Peterffy

Sure. It’s a profitable business, yes.

Rob Koehn

Okay. And then – well, I'll just leave it at that. Maybe to follow-up on the one other comment the other gentleman made, maybe it would be a good idea to have like a hedge fund day at IB headquarters to allow people to come see the facility and learn more about the company.

Thomas Peterffy

Thank you for the suggestion.

Rob Koehn

Okay, thank you.

Operator

Thank you. And that concludes our question-and-answer session for today. I'd like to turn the conference back over to Nancy Stuebe for any closing comments.

Nancy Stuebe

Thank you, everyone, for participating today. And as a reminder, this call will be available for replay on our website. We will also be posting a clean version of our transcript on our site tomorrow.

Thank you, again. 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 the program and you may now disconnect. Everyone, have a great evening.