

Interactive Brokers Group, Inc.

Form 10-Q

November 07, 2018

Table of Contents

---

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

---

FORM 10 Q

---

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from            to

Commission File Number: 001 33440

INTERACTIVE BROKERS GROUP, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Delaware 30 0390693  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

One Pickwick Plaza

Greenwich, Connecticut 06830

(Address of principal executive office)

(203) 618 5800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b 2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b 2 of the Exchange Act). Yes No

As of November 7, 2018, there were 75,097,440 shares of the issuer's Class A common stock, par value \$0.01 per share, outstanding and 100 shares of the issuer's Class B common stock, par value \$0.01 per share, outstanding.



Table of Contents

QUARTERLY REPORT ON FORM 10 Q FOR THE QUARTER ENDED SEPTEMBER 30, 2018

Table of Contents

PART I	FINANCIAL INFORMATION	
<u>ITEM 1.</u>	<u>Financial Statements (Unaudited)</u>	
	<u>Condensed Consolidated Statements of Financial Condition</u>	2
	<u>Condensed Consolidated Statements of Comprehensive Income</u>	3
	<u>Condensed Consolidated Statements of Cash Flows</u>	4
	<u>Condensed Consolidated Statements of Changes in Equity</u>	5
	<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>ITEM 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	38
<u>ITEM 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	68
<u>ITEM 4.</u>	<u>Controls and Procedures</u>	72
PART II.	OTHER INFORMATION	
<u>ITEM 1.</u>	<u>Legal Proceedings</u>	73
<u>ITEM 1A.</u>	<u>Risk Factors</u>	73
<u>ITEM 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	73
<u>ITEM 3.</u>	<u>Defaults upon Senior Securities</u>	74
<u>ITEM 5.</u>	<u>Other Information</u>	74
<u>ITEM 6.</u>	<u>Exhibits</u>	75
<u>SIGNATURES</u>		

Table of Contents

## PART 1. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (Unaudited)

Interactive Brokers Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Financial Condition

(Unaudited)

(in millions, except share amounts)	September 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	\$ 3,062	\$ 1,732
Cash - segregated for regulatory purposes	7,523	6,547
Securities - segregated for regulatory purposes	12,832	13,685
Securities borrowed	3,551	2,957
Securities purchased under agreements to resell	331	2,035
Financial instruments owned, at fair value:		
Financial instruments owned	2,276	1,950
Financial instruments owned and pledged as collateral	312	1,204
Total financial instruments owned, at fair value	2,588	3,154
Receivables		
Customers, less allowance for doubtful accounts of \$41 and \$40 as of September 30, 2018 and December 31, 2017	30,913	29,821
Brokers, dealers and clearing organizations	846	823
Interest	117	116
Total receivables	31,876	30,760

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Other assets	299	292
Total assets	\$ 62,062	\$ 61,162
Liabilities and equity		
Short-term borrowings	\$ 28	\$ 15
Securities loaned	3,834	4,444
Securities sold under agreements to repurchase	—	1,316
Financial instruments sold, but not yet purchased, at fair value	915	767
Payables		
Customers	49,823	47,548
Brokers, dealers and clearing organizations	179	283
Affiliate	171	187
Accounts payable, accrued expenses and other liabilities	174	147
Interest	35	22
Total payables	50,382	48,187
Total liabilities	55,159	54,729
Commitments, contingencies and guarantees (see Note 12)		
Equity		
Stockholders' equity		
Common stock, \$0.01 par value per share:		
Class A – Authorized - 1,000,000,000, Issued - 75,226,888 and 71,609,049 shares, Outstanding – 75,097,440 and 71,475,755 shares as of September 30, 2018 and December 31, 2017	1	1
Class B – Authorized, Issued and Outstanding – 100 shares as of September 30, 2018 and December 31, 2017	—	—
Additional paid-in capital	895	832
Retained earnings	354	251
Accumulated other comprehensive income, net of income taxes of \$0 and \$1 as of September 30, 2018 and December 31, 2017	(4)	9
Treasury stock, at cost, 129,448 and 133,294 shares as of September 30, 2018 and December 31, 2017	(3)	(3)
Total stockholders' equity	1,243	1,090
Noncontrolling interests	5,660	5,343
Total equity	6,903	6,433
Total liabilities and equity	\$ 62,062	\$ 61,162

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

(in millions, except share or per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues				
Commissions	\$ 167	\$ 163	572	477
Interest income	363	243	1,007	626
Trading gains	7	11	32	26
Other income	21	70	121	205
Total revenues	558	487	1,732	1,334
Interest expense	119	61	321	147
Total net revenues	439	426	1,411	1,187
Non-interest expenses				
Execution, clearing and distribution fees	57	61	196	185
Employee compensation and benefits	63	64	201	192
Occupancy, depreciation and amortization	12	11	35	34
Communications	7	7	20	22
General and administrative	25	15	70	67
Customer bad debt	(1)	—	2	2
Total non-interest expenses	163	158	524	502
Income before income taxes	276	268	887	685
Income tax expense	18	21	52	56
Net income	258	247	835	629
Less net income attributable to noncontrolling interests	219	216	709	551
Net income available for common stockholders	\$ 39	\$ 31	\$ 126	\$ 78
Earnings per share				
Basic	\$ 0.52	\$ 0.44	\$ 1.73	\$ 1.12
Diluted	\$ 0.51	\$ 0.43	\$ 1.71	\$ 1.10
Weighted average common shares outstanding				
Basic	74,649,469	71,109,577	72,879,007	69,405,624
Diluted	75,360,089	71,973,483	73,745,640	70,409,619

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Comprehensive income				
Net income available for common stockholders	\$ 39	\$ 31	\$ 126	\$ 78
Other comprehensive income				
Cumulative translation adjustment, before income taxes	(1)	1	(14)	11
Income taxes related to items of other comprehensive income	—	—	(1)	—
Other comprehensive income (loss), net of tax	(1)	1	(13)	11
Comprehensive income available for common stockholders	\$ 38	\$ 32	\$ 113	\$ 89
Comprehensive income attributable to noncontrolling interests				
Net income attributable to noncontrolling interests	\$ 219	\$ 216	\$ 709	\$ 551
Other comprehensive income - cumulative translation adjustment	(2)	5	(60)	55
Comprehensive income attributable to noncontrolling interests	\$ 217	\$ 221	\$ 649	\$ 606

See accompanying notes to the condensed consolidated financial statements.



Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in millions)	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 835	\$ 629
Adjustments to reconcile net income to net cash from operating activities		
Deferred income taxes	19	23
Depreciation and amortization	18	18
Employee stock plan compensation	42	38
Unrealized (gain) loss on other investments, net	—	(3)
Bad debt expense	2	2
Impairment loss	1	21
Change in operating assets and liabilities		
Securities - segregated for regulatory purposes	853	2,373
Securities borrowed	(594)	(566)
Securities purchased under agreements to resell	1,704	(478)
Financial instruments owned, at fair value	567	1,459
Receivables from customers	(1,094)	(5,926)
Other receivables	(24)	(14)
Other assets	7	(1)
Securities loaned	(610)	(161)
Securities sold under agreement to repurchase	(1,316)	—
Financial instruments sold, but not yet purchased, at fair value	148	(968)
Payable to customers	2,275	5,819
Other payables	(69)	30
Net cash provided by operating activities	2,764	2,295
Cash flows from investing activities		
Purchases of other investments	(21)	—
Distributions received and proceeds from sales of other investments	1	2
Purchase of property, equipment and intangible assets	(23)	(16)
Net cash used in investing activities	(43)	(14)
Cash flows from financing activities		
Short-term borrowings, net	13	(36)
Dividends paid to stockholders	(22)	(21)
Distributions from IBG LLC to noncontrolling interests	(299)	(222)

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Repurchases of common stock for employee tax withholdings under stock incentive plans	(45)	(21)
Proceeds from the sale of treasury stock	40	21
Payments made under the Tax Receivable Agreement	(28)	(15)
Net cash used in financing activities	(341)	(294)
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(74)	66
Net increase in cash, cash equivalents, and restricted cash	2,306	2,053
Cash, cash equivalents, and restricted cash at beginning of period	8,279	7,549
Cash, cash equivalents, and restricted cash at end of period	\$ 10,585	\$ 9,602
Cash, cash equivalents, and restricted cash		
Cash and cash equivalents	3,062	2,056
Cash segregated for regulatory purposes	7,523	7,546
Cash, cash equivalents, and restricted cash at end of period	\$ 10,585	\$ 9,602
Supplemental disclosures of cash flow information		
Cash paid for interest	\$ 308	\$ 136
Cash paid for taxes, net	\$ 35	\$ 31
Non-cash financing activities		
Issuance of common stock in exchange of member interests in IBG LLC	\$ 94	\$ 49
Redemption of member interests from IBG Holdings LLC	\$ (94)	\$ (49)
Adjustments to additional paid-in capital for changes in proportionate ownership in IBG LLC	\$ 28	\$ 28
Adjustments to noncontrolling interests for changes in proportionate ownership in IBG LLC	\$ (28)	\$ (28)
Non-cash distributions to noncontrolling interests	\$ (11)	\$ —

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Changes in Equity

Nine Months Ended September 30, 2018 and 2017

(Unaudited)

(in millions, except share amounts)	Common Stock		Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity	Non- controlling Interests	Total Equity
	Issued Shares	Par Value							
Balance, January 1, 2018	71,609,049	\$ 1	\$ 832	\$ (3)	\$ 251	\$ 9	\$ 1,090	\$ 5,343	\$ 6,433
Issuance of common stock in follow-on offering	1,537,727		25				25	(25)	—
Common stock distributed pursuant to stock incentive plans	2,080,112						—		—
Compensation for stock grants vesting in the future			7				7	35	42
Deferred tax benefit retained - follow-on offering			3				3		3
Repurchases of common stock for employee tax withholdings under stock incentive plans				(45)			(45)		(45)
Sales of treasury stock				45	(1)		44	(4)	40
Dividends paid to stockholders					(22)		(22)		(22)
Distributions from IBG LLC to							—	(310)	(310)

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

noncontrolling interests									
Adjustments for changes in proportionate ownership in IBG LLC			28				28	(28)	—
Comprehensive income					126	(13)	113	649	762
Balance, September 30, 2018	75,226,888	\$ 1	\$ 895	\$ (3)	\$ 354	\$ (4)	\$ 1,243	\$ 5,660	\$ 6,903

(in millions, except share amounts)	Common Stock			Accumulated			Non-controlling	Total	
	Issued	Par	Additional Paid-In	Treasury Stock	Retained Earnings	Other Comprehensive Income			Stockholders' Equity
Balance, January 1, 2017	Shares	Value	Capital	Stock	Earnings	Income	Equity	Interests	Equity
Balance, January 1, 2017	68,119,412	\$ 1	\$ 775	\$ (3)	\$ 203	\$ (2)	\$ 974	\$ 4,846	\$ 5,820
Issuance of common stock in follow-on offering	1,214,860		18				18	(18)	—
Common stock distributed pursuant to stock incentive plans	2,272,763						—		—
Compensation for stock grants vesting in the future			6				6	32	38
Deferred tax benefit retained - follow-on offering			2				2		2
Repurchases of common stock for employee tax withholdings under stock incentive plans				(21)			(21)		(21)
Sales of treasury stock				21			21		21
Dividends paid to stockholders					(21)		(21)		(21)
Distributions from IBG LLC to noncontrolling interests							—	(222)	(222)
Adjustments for changes in proportionate ownership in IBG LLC			28				28	(28)	—

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Comprehensive income					78	11	89	606	695
Balance, September 30, 2017	71,607,035	\$ 1	\$ 829	\$ (3)	\$ 260	\$ 9	\$ 1,096	\$ 5,216	\$ 6,312

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. Organization of Business

Interactive Brokers Group, Inc. (“IBG, Inc.”) is a Delaware holding company whose primary asset is its ownership of approximately 18.1% of the membership interests of IBG LLC, which, in turn, owns operating subsidiaries (collectively, “IBG LLC”). IBG, Inc. together with IBG LLC and its consolidated subsidiaries (collectively, “the Company”), is an automated global electronic broker specializing in executing and clearing trades in securities, futures, foreign exchange instruments, bonds and mutual funds on more than 120 electronic exchanges and market centers around the world and offering custody, prime brokerage, securities and margin lending services to customers. In the United States of America (“U.S.”), the Company conducts its business primarily from its headquarters in Greenwich, Connecticut and from Chicago, Illinois. Abroad, the Company conducts its business through offices located in Canada, the United Kingdom, Switzerland, India, China (Hong Kong and Shanghai), Japan, and Australia. As of September 30, 2018, the Company had 1,380 employees worldwide.

IBG LLC is a Connecticut limited liability company that conducts its business through its operating subsidiaries (collectively, the “Operating Companies”): Interactive Brokers LLC (“IB LLC”); Interactive Brokers (India) Private Limited (“IBI”); Timber Hill LLC (“TH LLC”); Timber Hill Canada Company (“THC”); Interactive Brokers Software Services (India) Private Limited (“IBSSI”); IB Global Investments LLC (“IBGIL”); IB Exchange Corp. (“IBEC”) and its subsidiaries, Interactive Brokers Canada Inc. (“IBC”), Interactive Brokers (U.K.) Limited and its subsidiary, Interactive Brokers (U.K.) Nominee Limited (collectively, “IBUK”), Interactive Brokers Securities Japan, Inc. (“IBSJ”), Interactive Brokers Hong Kong Limited (“IBHK”), Interactive Brokers Australia Pty Limited and its subsidiary, Interactive Brokers Australia Nominees Pty Limited (collectively, “IBA”), IB Business Services (Shanghai) Company Limited (“IBBSS”), IBKR Financial Services AG (formerly Timber Hill Europe AG) and its subsidiary, THLI AG (formerly Timber Hill (Liechtenstein) AG) (collectively, “IBKRFS”), Interactive Brokers Hungary KFT (“IBH”), Interactive Brokers Software Services Estonia OU (“IBEST”), Interactive Brokers Software Services Russia (“IBRUS”), Interactive Brokers Corp. (“IB Corp”), Covestor, Inc. and its subsidiary, Covestor Limited (collectively, “Covestor”), and Greenwich Advisor Compliance Services Corp. (“Greenwich Compliance”).

The Company operates in two business segments: electronic brokerage and market making, both supported by corporate. The Company conducts its electronic brokerage business through certain Interactive Brokers subsidiaries, which provide electronic execution and clearing services to customers worldwide. The Company conducts its market making business principally through its Timber Hill subsidiaries and it currently consists of customer facilitation in products such as CFDs, ETFs and single stock futures, as well as exchange traded market making activities in a few select markets outside the U.S. (See Note 2 – Discontinued Operations and Costs Associated with Exit or Disposal Activities). Corporate enables the Company to operate cohesively and effectively by providing support via development services and control functions to the business segments and also by executing the Company’s currency diversification strategy.

Certain of the Operating Companies are members of various securities and commodities exchanges in North America, Europe and the Asia/Pacific region and are subject to regulatory capital and other requirements (see Note 14). IB LLC,

IBC, IBUK, IBSJ, IBHK, IBI and IBA carry securities accounts for customers or perform custodial functions relating to customer securities.

## 2. Significant Accounting Policies

### Basis of Presentation

These condensed consolidated financial statements are presented in U.S. dollars and have been prepared in accordance with accounting principles generally accepted in the U.S. (“U.S. GAAP”) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) regarding financial reporting with respect to Form 10 Q.

These condensed consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s 2017 Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on March 1, 2018. The condensed consolidated financial information as of December 31, 2017 has been derived from the audited consolidated financial statements not included herein.

These condensed consolidated financial statements include the accounts of the Company and its consolidated subsidiaries and reflect all adjustments of a normal and recurring nature that are, in the opinion of management, necessary for the fair presentation of the results for the periods presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Principles of Consolidation, including Noncontrolling Interests

These condensed consolidated financial statements include the accounts of IBG, Inc. and its majority and wholly owned subsidiaries. As sole managing member of IBG LLC, IBG, Inc. exerts control over IBG LLC's operations. In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 810, "Consolidation," the Company consolidates IBG LLC's financial statements and records the interests in IBG LLC that it does not own as noncontrolling interests.

The Company's policy is to consolidate all other entities in which it owns more than 50% unless it does not have control. All inter company balances and transactions have been eliminated.

Condensed Consolidated Statements of Cash Flows and Financial Condition Presentation Changes

On January 1, 2018, the Company adopted FASB Accounting Standards Update ("ASU") No. 2016-18, "Statement of Cash Flows (Topic 230) – Restricted Cash" ("ASU 2016-18"). This accounting update requires an entity to include in its cash and cash equivalents amounts that are deemed to be restricted cash and to present a reconciliation of such amounts in the statement of cash flows. Restricted cash represents cash and cash equivalents that are subject to withdrawal or usage restrictions. For purposes of the condensed consolidated statements of cash flows, cash, cash equivalents, and restricted cash consist of "cash and cash equivalents" and "cash – segregated for regulatory purposes."

ASU 2016-18 also requires prior periods to be retrospectively adjusted to conform to the current period presentation. Upon adoption, the Company recorded an increase of \$1,922 million in net cash provided by operating activities, for the nine months ended September 30, 2017 to reflect the reclassification of changes in restricted cash balances from the operating section to the cash, cash equivalent, and restricted cash balances within the condensed consolidated statements of cash flows.

In addition, the Company reclassified restricted cash amounts previously included within "cash and securities – segregated for regulatory purposes" into a separate line item, "cash – segregated for regulatory purposes," in the condensed consolidated statements of financial condition to be consistent with the presentation of restricted cash in the condensed consolidated statements of cash flows under ASU 2016-18. Previously reported amounts in the condensed consolidated statements of financial condition and notes to the condensed consolidated financial statements have been adjusted to conform to the current presentation.



Discontinued Operations and Costs Associated with Exit or Disposal Activities

On March 8, 2017, the Company announced its intention to discontinue its options market making activities globally. Additionally, as previously announced, on September 29, 2017 the Company completed the transfer of its U.S. options market making operations to Two Sigma Securities, LLC. The Company also exited the majority of its market making activities outside of the U.S. by December 31, 2017 and expects to report discontinued operations when it meets the criteria under FASB Topic ASC 205-20, "Discontinued Operations."

The Company recognized approximately \$25 million in one-time restructuring costs during the year ended December 31, 2017. The one-time restructuring costs included approximately \$22 million of non-cash expenditures, consisting of impairment of the carrying value of certain exchange trading rights and stock-based compensation and \$3 million of cash expenditures primarily related to severance costs for employee terminations.

During the nine months ended September 30, 2018, the Company did not incur any additional restructuring costs. During the nine months ended September 30, 2017, the Company recorded restructuring costs of approximately \$21 million for the impairment of exchange trading rights, included in general and administrative expenses and approximately \$3 million in severance costs resulting from obligations related to employment terminations, included in employee compensation and benefits in the condensed consolidated statements of comprehensive income.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures in these condensed consolidated financial statements and accompanying notes. These estimates and assumptions are based on judgment and the best available information at the time. Therefore, actual results could differ materially from those estimates. Such estimates include the allowance for doubtful accounts, valuation of certain investments, compensation accruals, current and deferred income taxes, costs associated with exit or disposal activities, and contingency reserves.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Fair Value

Substantially all of the Company's assets and liabilities, including financial instruments are carried at fair value based on published market prices and are marked to market, or are assets and liabilities which are short term in nature and are carried at amounts that approximate fair value.

The Company applies the fair value hierarchy in accordance with FASB ASC Topic 820, "Fair Value Measurement" ("ASC Topic 820"), to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy are:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 Quoted prices for similar assets in an active market, quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3 Prices or valuations that require inputs that are both significant to fair value measurement and unobservable. Financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value are generally classified as Level 1 of the fair value hierarchy. The Company's Level 1 financial instruments, which are valued using quoted market prices as published by exchanges and clearing houses or otherwise broadly distributed in active markets, include active listed stocks, options, warrants, and U.S. and foreign government securities. The Company does not adjust quoted prices for financial instruments classified as Level 1 of the fair value hierarchy, even in the event that the Company may hold a large position whereby a purchase or sale could reasonably impact quoted prices.

Currency forward contracts are valued using broadly distributed bank and broker prices, and are classified as Level 2 of the fair value hierarchy since inputs to their valuation can be generally corroborated by market data. Other securities that are not traded in active markets are also classified as Level 2 of the fair value hierarchy. Level 3 financial instruments are comprised of securities that have been delisted or otherwise are no longer tradable in active markets and have been valued by the Company based on internal estimates.

Earnings per Share

Earnings per share ("EPS") is computed in accordance with FASB ASC Topic 260, "Earnings per Share." Basic EPS is computed by dividing the net income available for common stockholders by the weighted average number of shares outstanding for that period. Diluted EPS is calculated by dividing the net income available for common stockholders by the diluted weighted average shares outstanding for that period. Diluted EPS includes the determinants of the basic EPS and, in addition, reflects the dilutive effect of shares of common stock estimated to be distributed in the future under the Company's stock-based compensation plans, with no adjustments to net income available for common

stockholders for dilutive potential common shares.

#### Stock Based Compensation

The Company follows FASB ASC Topic 718, "Compensation - Stock Compensation" ("ASC Topic 718"), to account for its stock based compensation plans. ASC Topic 718 requires all share based payments to employees to be recognized in the condensed consolidated financial statements using a fair value based method. Grants, which are denominated in U.S. dollars, are communicated to employees in the year of grant, thereby establishing the fair value of each grant. The fair value of awards granted to employees are generally expensed as follows: 50% in the year of grant in recognition of the plans' post-employment provisions (as described below) and the remaining 50% over the related vesting period utilizing the "graded vesting" method permitted under ASC Topic 718. In the case of "retirement eligible" employees (those employees older than 59), 100% of awards are expensed when granted.

Awards granted under stock based compensation plans are subject to the plans' post-employment provisions in the event an employee ceases employment with the Company. The plans provide that employees who discontinue employment with the Company without cause and continue to meet the terms of the plans' post employment provisions will be eligible to earn 50% of previously granted but not yet earned awards, unless the employee is over the age of 59, in which case the employee would be eligible to receive 100% of previously granted but not yet earned awards.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Cash and Cash Equivalents

Cash and cash equivalents consist of deposits with banks and all highly liquid investments, with maturities of three months or less, that are not segregated and deposited for regulatory purposes or to meet margin requirements at clearing houses.

Cash and Securities - Segregated for Regulatory Purposes

As a result of customer activities, certain Operating Companies are obligated by rules mandated by their primary regulators to segregate or set aside cash or qualified securities to satisfy such regulations, which have been promulgated to protect customer assets. Securities segregated for regulatory purposes consisted of U.S. government securities of \$4.1 billion and \$4.5 billion as of September 30, 2018 and December 31, 2017, respectively, and securities purchased under agreements to resell in the amount of \$8.7 billion and \$9.2 billion as of September 30, 2018 and December 31, 2017, respectively, which amounts approximate fair value.

Securities Borrowed and Securities Loaned

Securities borrowed and securities loaned are recorded at the amount of the cash collateral advanced or received. Securities borrowed transactions require the Company to provide counterparties with collateral, which may be in the form of cash, letters of credit or other securities. With respect to securities loaned, the Company receives collateral, which may be in the form of cash or other securities in an amount generally in excess of the fair value of the securities loaned. The Company monitors the market value of securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as permitted contractually. It is the Company's policy to net, in the condensed consolidated statements of financial condition, securities borrowed and securities loaned entered into with the same counterparty that meet the offsetting requirements prescribed in FASB ASC Topic 210-20, "Balance Sheet – Offsetting" ("ASC Topic 210-20").

Securities lending fees received and paid by the Company are included in interest income and interest expense, respectively, in the condensed consolidated statements of comprehensive income.

Securities Purchased Under Agreements to Resell and Securities Sold Under Agreements to Repurchase

Securities purchased under agreements to resell and securities sold under agreements to repurchase, which are reported as collateralized financing transactions, are recorded at contract value, which approximates fair value. To ensure that the fair value of the underlying collateral remains sufficient, the collateral is valued daily with additional collateral obtained or excess collateral returned, as permitted under contractual provisions. It is the Company's policy to net, in the condensed consolidated statements of financial condition, securities purchased under agreements to resell transactions and securities sold under agreements to repurchase transactions entered into with the same counterparty that meet the offsetting requirements prescribed in ASC Topic 210-20.

Financial Instruments Owned and Financial Instruments Sold, But Not Yet Purchased, at Fair Value

Financial instrument transactions are accounted for on a trade date basis. Financial instruments owned and financial instruments sold, but not yet purchased are stated at fair value based upon quoted market prices, or if not available, are valued by the Company based on internal estimates (see Fair Value above). The Company's financial instruments pledged to counterparties where the counterparty has the right, by contract or custom, to sell or repledge the financial instruments are reported as financial instruments owned and pledged as collateral in the condensed consolidated statements of financial condition.

#### Customer Receivables and Payables

Customer securities transactions are recorded on a settlement date basis and customer commodities transactions are recorded on a trade date basis. Receivables from and payables to customers include amounts due on cash and margin transactions, including futures contracts transacted on behalf of customers. Securities owned by customers, including those that collateralize margin loans or other similar transactions, are not reported in the condensed consolidated statements of financial condition. Amounts receivable from customers that are determined by management to be uncollectible are recorded as customer bad debt expense in the condensed consolidated statements of comprehensive income.

#### Receivables from and Payables to Brokers, Dealers and Clearing Organizations

Receivables from and payables to brokers, dealers and clearing organizations include net receivables and payables from unsettled trades, including amounts related to futures and options on futures contracts executed on behalf of customers, amounts receivable for securities not delivered by the Company to the purchaser by the settlement date ("fails to deliver") and cash deposits. Payables to brokers, dealers and clearing organizations also include amounts payable for securities not received by the Company from a seller by the settlement date ("fails to receive").

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Investments

The Company makes certain strategic investments related to its business and accounts for these investments (a) under the equity method of accounting as required under FASB ASC Topic 323, “Investments - Equity Method and Joint Ventures” or (b) at fair value or, if the investment in equity securities does not have a readily determinable fair value, at historical cost, less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer in accordance with FASB ASC Topic 321, “Investments in Equity Securities.”

Investments accounted for under the equity method, including where the investee is a limited partnership or limited liability company, are recorded at the fair value amount of the Company’s initial investment and are adjusted each period for the Company’s share of the investee’s income or loss. The Company’s share of the income or losses from equity method investments is included in other income in the condensed consolidated statements of comprehensive income. The recorded amounts of the Company’s equity method investments of \$23 million as of September 30, 2018 and December 31, 2017, respectively, which are included in other assets in the condensed consolidated statements of financial condition, increase or decrease accordingly. Contributions paid to and distributions received from equity method investees are recorded as additions or reductions, respectively, to the respective investment balance.

Investments in equity securities that do not qualify for equity method accounting and do not have readily determinable fair values are recorded at historical cost, less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The recorded amounts of the Company’s investments in such equity securities of \$26 million and \$5 million as of September 30, 2018 and December 31, 2017, respectively, are included in other assets in the condensed consolidated statements of financial condition. Dividends received from these investments are included in other income in the condensed consolidated statements of comprehensive income when such dividends are received.

The Company also holds exchange memberships and investments in equity securities of certain exchanges, as required to qualify as a clearing member. Such investments of \$5 million and \$6 million as of September 30, 2018 and December 31, 2017, respectively, are recorded at cost less impairment, and are included in other assets in the condensed consolidated statements of financial condition. Dividends received from these investments are included in other income in the condensed consolidated statements of comprehensive income when such dividends are received.

A judgmental aspect of accounting for investments is evaluating whether a decline in the value of an investment has occurred. The evaluation of an impairment is dependent on specific quantitative and qualitative factors and circumstances surrounding an investment, including recurring operating losses, credit defaults and subsequent rounds of financing. The Company’s equity investments do not have readily determinable market values. All investments are reviewed for changes in circumstances or occurrence of events that suggest the Company’s investment may not be recoverable. An impairment loss, if any, is recognized in the period the determination is made.

Property, Equipment, and Intangible Assets

Property, equipment, and intangible assets, which are included in other assets in the condensed consolidated statements of financial condition, consist of leasehold improvements, computer equipment, software developed for the Company's internal use, office furniture, equipment and acquired technology.

Property and equipment are recorded at historical cost, less accumulated depreciation and amortization. Additions and improvements that extend the lives of assets are capitalized, while expenditures for repairs and maintenance are expensed as incurred. Depreciation and amortization are computed using the straight line method. Equipment is depreciated over the estimated useful lives of the assets, while leasehold improvements are amortized over the lesser of the estimated economic useful life of the asset or the term of the lease. Computer equipment is depreciated over three to five years and office furniture and equipment are depreciated over five to seven years. Intangible assets with a finite life are amortized on a straight line basis over their estimated useful lives of three years, and tested for recoverability whenever events indicate that the carrying amounts may not be recoverable. Qualifying costs for internally developed software are capitalized and amortized over the expected useful life of the developed software, not to exceed three years. Upon retirement or disposition of property and equipment, the cost and related accumulated depreciation are removed from the condensed consolidated statements of financial condition and any resulting gain or loss is recorded in other income in the condensed consolidated statements of comprehensive income. Fully depreciated (or amortized) assets are retired on an annual basis.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Comprehensive Income and Foreign Currency Translation

The Company's operating results are reported in the condensed consolidated statements of comprehensive income pursuant to FASB ASC Topic 220, "Comprehensive Income."

Comprehensive income consists of two components: net income and other comprehensive income ("OCI"). The Company's OCI is comprised of gains and losses resulting from translating foreign currency financial statements of non-U.S. subsidiaries, net of related income taxes, where applicable. In general, the practice and intention of the Company is to reinvest the earnings of its non U.S. subsidiaries in those operations, therefore tax is usually not accrued on OCI.

The Company's non U.S. domiciled subsidiaries have a functional currency that is other than the U.S. dollar. Such subsidiaries' assets and liabilities are translated into U.S. dollars at period end exchange rates, and revenues and expenses are translated at average exchange rates prevailing during the period. Adjustments that result from translating amounts from a subsidiary's functional currency to the U.S. dollar (as described above) are reported net of tax, where applicable, in accumulated OCI in the condensed consolidated statements of financial condition. During the three months ended June 30, 2018, the Company liquidated its Australian subsidiary, Timber Hill Australia Pty Limited, and accordingly reclassified the accumulated OCI of \$32 million to other income and the related accumulated tax effect of \$1 million to income tax expense in the condensed consolidated statements of comprehensive income.

Revenue Recognition

Commissions

Commissions earned for executing and/or clearing transactions are accrued on a trade date basis and are reported as commissions in the condensed consolidated statements of comprehensive income. See Note 8 for further information on revenue from contracts with customers.

Interest Income and Expense

The Company earns interest income and incurs interest expense primarily in connection with its electronic brokerage customer business and its securities lending activities, which are recorded on an accrual basis and are included in interest income and interest expense, respectively, in the condensed consolidated statements of comprehensive income.

Trading Gains

Trading gains and losses are recorded on trade date and are reported on a net basis. Trading gains and losses are comprised of changes in the fair value of financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value (i.e., unrealized gains and losses) and realized gains and losses related to the



Company's market making business segment. Included in trading gains are net gains and losses on stocks, U.S. and foreign government securities, options, futures, foreign exchange and other derivative instruments. Dividends are integral to the valuation of stocks and interest is integral to the valuation of fixed income instruments. Accordingly, both dividends and interest income and expense attributable to financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value, held for market making purposes, are reported on a net basis in trading gains in the condensed consolidated statements of comprehensive income.

#### Foreign Currency Gains and Losses

Foreign currency balances are assets and liabilities in currencies other than the Company's functional currency. At every reporting date, the Company revalues its foreign currency balances to its functional currency at the spot exchange rate and records the associated foreign currency gains and losses. These foreign currency gains and losses are reported in the condensed consolidated statements of comprehensive income, as follows: (a) foreign currency gains and losses related to the Company's currency diversification strategy are reported in other income; (b) foreign currency gains and losses related to the market making core-business activities are reported in trading gains; (c) foreign currency gains and losses arising from currency swap transactions in the electronic brokerage business are reported in interest income; and (d) all other foreign currency gains and losses are reported in other income.

#### Rebates

Rebates consist of volume discounts, credits or payments received from exchanges or other market centers related to the placement and/or removal of liquidity from the order flow in the marketplace and are recorded on an accrual basis. Rebates are recorded net within execution, clearing and distribution fees in the condensed consolidated statements of comprehensive income. Rebates received for trades executed on behalf of customers that elect tiered pricing are passed, in whole or part, to these customers; and such pass-through amounts are recorded net within commissions in the condensed consolidated statements of comprehensive income.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Income Taxes

The Company accounts for income taxes in accordance with FASB ASC Topic 740, "Income Taxes" ("ASC Topic 740"). The Company's income tax expense, deferred tax assets and liabilities, and reserves for unrecognized tax benefits are based on enacted tax laws (see Note 11) and reflect management's best assessment of estimated future taxes to be paid. The Company is subject to income taxes in the U.S. and numerous foreign jurisdictions. Determining income tax expense requires significant judgment and estimates.

Deferred income tax assets and liabilities arise from temporary differences between the tax and financial statement recognition of underlying assets and liabilities. In evaluating the ability to recover deferred tax assets within the jurisdictions from which they arise, the Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, historical results are adjusted for changes in accounting policies and incorporate assumptions including the amount of future state, federal and foreign pre-tax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates the Company is using to manage the underlying businesses. In evaluating the objective evidence that historical results provide, three years of cumulative operating income (loss) are considered. Deferred income taxes have not been provided for U.S. tax liabilities or for additional foreign taxes on the unremitted earnings of foreign subsidiaries that have been indefinitely reinvested.

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in a multitude of jurisdictions across the Company's global operations. Changes in tax laws and rates could also affect recorded deferred tax assets and liabilities in the future. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted, significantly revising the U.S corporate income tax law by, among other things, reducing the corporate income tax rate from 35% to 21% and implementing a modified territorial tax system that includes a one-time transition tax on deemed repatriated earnings of foreign subsidiaries (see Note 11).

The Company records tax liabilities in accordance with ASC Topic 740 and adjusts these liabilities when management's judgment changes as a result of the evaluation of new information not previously available. Because of the complexity of some of these uncertainties, the ultimate resolution may result in payments that are different from the current estimates of these tax liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which new information becomes available.

The Company recognizes a tax benefit from an uncertain tax position only when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, on the basis of the technical merits. A tax position that meets this standard is measured at the largest amount of benefit that will more likely than not be realized on settlement.

The Company recognizes interest related to income tax matters as interest income or interest expense and penalties related to income tax matters as income tax expense in the condensed consolidated statements of comprehensive income.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

## Recently Issued Accounting Pronouncements

Following is a summary of recently issued FASB Accounting Standards Updates (“ASUs”) that have affected or may affect the Company’s condensed consolidated financial statements:

Affects	Status	
ASU 2016-02	Leases (Topic 842): Requires the recognition of a right-of-use asset and a lease liability for leases previously classified as operating lease in the statements of financial condition.	Effective for fiscal years beginning after December 15, 2018.
ASU 2016-13	Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.	Effective for fiscal years beginning after December 15, 2019.
ASU 2017-04	Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.	Effective for fiscal years beginning after December 15, 2019.
ASU 2017-08	Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Amending the amortization period for certain purchased callable debt securities held at a premium.	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.
ASU 2017-11	Earnings Per Share (Topic 260) Distinguishing Liabilities from Equity (Topic 480) Derivatives and Hedging (Topic 815): changing the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features.	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.
ASU 2017-12	Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.
ASU 2018-02	Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.	Effective for fiscal years and first interim periods beginning after December 15, 2018.
ASU 2018-03	Technical Correction and Improvements to Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.	Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years beginning after June 15, 2018.
ASU 2018-07	Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting.	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

ASU 2018-08	Not for Profit Entities (Topic 958) and Other Expenses - Contributions (Topic 720): Clarifying the Scope and the Accounting for Contributions Received and Contributions Made.	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.
ASU 2018-10	Leases (Topic 842): Codification Improvements.	Effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods.
ASU 2018-11	Leases (Topic 842): Targeted Improvements.	Effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods.
ASU 2018-13	Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.	Effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods.
ASU 2018-15	Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.	Effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Adoption of the ASUs that became effective during 2017 and 2018, prior to the issuance of the Company's condensed consolidated financial statements, had no material effect on these financial statements, except as described in the notes to these financial statements.

ASU 2016-01, "Leases (Topic 842)" is effective for the Company in January 2019 and will be implemented under the "prospective" transitional method prescribed in ASU 2018-11, "Leases (Topic 842) – Targeted Improvements". The Company's implementation efforts include reviewing the terms of existing leases and service contracts, which may include embedded leases. Based on the implementation efforts to date, the Company expects a gross up on its consolidated statements of financial condition upon recognition of the right-of-use assets and lease liabilities but does not expect the amount of the gross up to have a material impact on its consolidated statements financial condition.

### 3. Trading Activities and Related Risks

The Company's trading activities include providing securities brokerage and market making services. Trading activities expose the Company to market and credit risks. These risks are managed in accordance with established risk management policies and procedures. To accomplish this, management has established a risk management process that includes:

- a regular review of the risk management process by executive management as part of its oversight role;
- defined risk management policies and procedures supported by a rigorous analytic framework; and
- articulated risk tolerance levels as defined by executive management that are regularly reviewed to ensure that the Company's risk taking is consistent with its business strategy, capital structure, and current and anticipated market conditions.

#### Market Risk

The Company is exposed to various market risks. Exposures to market risks arise from equity price risk, foreign currency exchange rate fluctuations and changes in interest rates. The Company seeks to mitigate market risk associated with trading inventories by employing hedging strategies that correlate rate, price and spread movements of trading inventories and related financing and hedging activities. The Company uses a combination of cash instruments and exchange traded derivatives to hedge its market exposures. The Company does not apply hedge accounting. The following discussion describes the types of market risk faced:

#### Equity Price Risk

Equity price risk arises from the possibility that equity security prices will fluctuate, affecting the value of equity securities and other instruments that derive their value from a particular stock, a defined basket of stocks, or a stock index. The Company is subject to equity price risk primarily in financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value. The Company attempts to limit such risks by continuously reevaluating prices and by diversifying its portfolio across many different options, futures and underlying securities and avoiding concentrations of positions based on the same underlying security.

#### Currency Risk

Currency risk arises from the possibility that fluctuations in foreign exchange rates will impact the value of financial instruments. The Company manages this risk using spot (i.e., cash) currency transactions, currency futures contracts and currency forward contracts. As a global electronic broker and market maker trading on exchanges around the world in multiple currencies, the Company is exposed to foreign currency risk. The Company actively manages its currency exposure using a currency diversification strategy that is based on a defined basket of 14 currencies internally referred to as the "GLOBAL." These strategies minimize the fluctuation of the Company's net worth as expressed in GLOBALs, thereby diversifying its risk in alignment with these global currencies, weighted by the Company's view of their importance. As the Company's financial results are reported in U.S. dollars, the change in the value of the GLOBAL as expressed in U.S. dollars affects the Company's earnings. The impact of this currency diversification strategy in the Company's earnings is included in other income in the condensed consolidated statements of comprehensive income.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Interest Rate Risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Company is exposed to interest rate risk on cash and margin balances, positions carried in equity and fixed income securities, options, futures and on its borrowings. These risks are managed through investment policies and/or by entering into interest rate futures contracts.

Credit Risk

The Company is exposed to risk of loss if a customer, counterparty or issuer fails to perform its obligations under contractual terms (“default risk”). Both cash instruments and derivatives expose the Company to default risk. The Company has established policies and procedures for mitigating credit risk on principal transactions, including reviewing and establishing limits for credit exposure, maintaining collateral, and continually assessing the creditworthiness of counterparties.

The Company’s credit risk is limited in that substantially all of the contracts entered into are settled directly at securities and commodities clearing houses and a small portion is settled through member firms and banks with substantial financial and operational resources. The Company seeks to control the risks associated with its customer margin activities by requiring customers to maintain collateral in compliance with regulatory and internal guidelines.

In the normal course of business, the Company executes, settles, and finances various customer securities transactions. Execution of these transactions includes the purchase and sale of securities which exposes the Company to default risk arising from the potential that customers or counterparties may fail to satisfy their obligations. In these situations, the Company may be required to purchase or sell financial instruments at unfavorable market prices to satisfy obligations to customers or counterparties. Liabilities to other brokers and dealers related to unsettled transactions (i.e., securities fails to receive) are recorded at the amount for which the securities were purchased, and are paid upon receipt of the securities from other brokers or dealers. In the case of aged securities fails to receive, the Company may purchase the underlying security in the market and seek reimbursement for any losses from the counterparty.

For cash management purposes, the Company enters into short term securities purchased under agreements to resell and securities sold under agreements to repurchase transactions (“repos”) in addition to securities borrowing and lending arrangements, all of which may result in credit exposure in the event the counterparty to a transaction is unable to fulfill its contractual obligations. Repos are collateralized by securities with a market value in excess of the obligation under the contract. Similarly, securities lending agreements are collateralized by deposits of cash or securities. The Company attempts to minimize credit risk associated with these activities by monitoring collateral values on a daily basis and requiring additional collateral to be deposited with or returned to the Company as permitted under contractual provisions.

Concentrations of Credit Risk



The Company's exposure to credit risk associated with its trading and other activities is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. Concentrations of credit risk can be affected by changes in political, industry, or economic factors. To reduce the potential for risk concentration, credit limits are established and exposure is monitored in light of changing counterparty and market conditions. As of September 30, 2018, the Company did not have any material concentrations of credit risk outside the ordinary course of business.

#### Off Balance Sheet Risks

The Company may be exposed to a risk of loss not reflected in the condensed consolidated financial statements to settle futures and certain over the counter contracts at contracted prices, which may require repurchase or sale of the underlying products in the market at prevailing prices. Accordingly, these transactions result in off balance sheet risk as the Company's cost to liquidate such contracts may exceed the amounts reported in the Company's condensed consolidated statements of financial condition.

#### 4. Equity and Earnings per Share

In connection with IBG, Inc.'s initial public offering of Class A common stock ("IPO") in May 2007, it purchased 10.0% of the membership interests in IBG LLC from IBG Holdings LLC ("Holdings"), became the sole managing member of IBG LLC and began to consolidate IBG LLC's financial results into its financial statements. Holdings owns all of IBG, Inc.'s Class B common stock, which has voting rights in proportion to its ownership interests in IBG LLC.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

The table below shows the amount of IBG LLC membership interests held by IBG, Inc. and Holdings as of September 30, 2018.

	IBG, Inc.	Holdings	Total
Ownership %	18.1%	81.9%	100.0%
Membership interests	75,097,443	338,691,717	413,789,160

These condensed consolidated financial statements reflect the results of operations and financial position of IBG, Inc., including consolidation of its investment in IBG LLC and its subsidiaries. The noncontrolling interests in IBG LLC attributable to Holdings are reported as a component of total equity in the condensed consolidated statements of financial condition.

## Recapitalization and Post IPO Capital Structure

Immediately prior to and immediately following the consummation of the IPO, IBG, Inc., Holdings, IBG LLC and the members of IBG LLC consummated a series of transactions collectively referred to herein as the "Recapitalization." In connection with the Recapitalization, IBG, Inc., Holdings and the historical members of IBG LLC entered into an exchange agreement, dated as of May 3, 2007 (the "Exchange Agreement"), pursuant to which the historical members of IBG LLC received membership interests in Holdings in exchange for their membership interests in IBG LLC. Additionally, IBG, Inc. became the sole managing member of IBG LLC.

In connection with the consummation of the IPO, Holdings used the net proceeds to redeem 10.0% of members' interests in Holdings in proportion to their interests. Immediately following the Recapitalization and IPO, Holdings owned approximately 90% of IBG LLC and 100% of IBG, Inc.'s Class B common stock.

Since consummation of the IPO and Recapitalization, IBG, Inc.'s equity capital structure has been comprised of Class A and Class B common stock. All shares of common stock have a par value of \$0.01 per share and have identical rights to earnings and dividends and in liquidation. As of September 30, 2018 and December 31, 2017, 1,000,000,000 shares of Class A common stock were authorized, of which 75,226,888 and 71,609,049 shares have been issued; and 75,097,440 and 71,475,755 shares were outstanding, respectively. Class B common stock is comprised of 100 authorized shares, of which 100 shares were issued and outstanding as of September 30, 2018 and December 31, 2017, respectively. In addition, 10,000 shares of preferred stock have been authorized, of which no shares are issued or outstanding as of September 30, 2018 and December 31, 2017, respectively.

As a result of a federal income tax election made by IBG LLC applicable to the acquisition of IBG LLC member interests by IBG, Inc., the income tax basis of the assets of IBG LLC acquired by IBG, Inc. have been adjusted based on the amount paid for such interests. Deferred tax assets were recorded as of the IPO date and in connection with

subsequent redemptions of Holdings member interests in exchange for common stock. These deferred tax assets are included in other assets in the Company's condensed consolidated statements of financial condition and are being amortized as additional deferred income tax expense over 15 years from the IPO date and from the additional redemption dates, respectively, as allowable under current tax law. As of September 30, 2018 and December 31, 2017, the unamortized balance of these deferred tax assets was \$145 million and \$146 million, respectively.

IBG, Inc. also entered into an agreement (the "Tax Receivable Agreement") with Holdings to pay Holdings (for the benefit of the former members of IBG LLC) 85% of the tax savings that IBG, Inc. actually realizes as the result of tax basis increases. These payables to Holdings are reported as payable to affiliate in the Company's condensed consolidated statements of financial condition. The remaining 15% is accounted for as a permanent increase to additional paid in capital in the Company's condensed consolidated statements of financial condition.

The cumulative amounts of deferred tax assets, payables to Holdings and additional paid in capital arising from stock offerings from the date of the IPO through September 30, 2018 were \$501 million, \$426 million, and \$75 million, respectively. Amounts payable under the Tax Receivable Agreement are payable to Holdings annually following the filing of IBG, Inc.'s federal income tax return. The Company has paid Holdings a cumulative total of \$159 million through September 30, 2018 pursuant to the terms of the Tax Receivable Agreement.

The Exchange Agreement, as amended, provides for future redemptions of member interests and for the purchase of member interests in IBG LLC by IBG, Inc. from Holdings, which could result in IBG, Inc. acquiring the remaining member interests in IBG LLC that it does not own. On an annual basis, members of Holdings are able to request redemption of their interests.

At the time of IBG, Inc.'s IPO in 2007, three hundred sixty (360) million shares of authorized common stock were reserved for future sales and redemptions. From 2008 through 2010, Holdings redeemed 5,013,259 IBG LLC interests with a total value of \$114 million, which redemptions were funded using cash on hand at IBG LLC. Upon cash redemption these IBG LLC interests were retired. From 2011 through 2017, IBG, Inc. issued 13,858,355 shares of common stock (with a fair value of \$410 million) directly to Holdings in exchange for an equivalent number of member interests in IBG LLC.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

As a consequence of these redemption transactions, and distribution of shares to employees (see Note 10), IBG, Inc.'s interest in IBG LLC has increased to approximately 18.1%, with Holdings owning the remaining 81.9% as of September 30, 2018. The redemptions also resulted in an increase in the Holdings interest held by Mr. Thomas Peterffy and his affiliates from approximately 84.6% at the IPO to approximately 89.6% as of September 30, 2018.

On July 27, 2018, the Company filed a Prospectus Supplement on Form 424B5 (File Number 333-219552) with the SEC to issue 1,537,727, shares of common stock (with a fair value of \$94 million) in exchange for an equivalent number of shares of member interests in IBG LLC. This issuance of shares increased the Company's ownership in IBG LLC from 17.8% to 18.1%.

## Earnings per Share

Basic earnings per share is calculated utilizing net income available for common stockholders divided by the weighted average number of shares of Class A and Class B common stock outstanding for that period.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in millions, except share or per share amounts)			
Basic earnings per share				
Net income available for common stockholders	\$ 39	\$ 31	\$ 126	\$ 78
Weighted average shares of common stock outstanding				
Class A	74,649,369	71,109,477	72,878,907	69,405,524
Class B	100	100	100	100
	74,649,469	71,109,577	72,879,007	69,405,624
Basic earnings per share	\$ 0.52	\$ 0.44	\$ 1.73	\$ 1.12

Diluted earnings per share are calculated utilizing the Company's basic net income available for common stockholders divided by diluted weighted average shares outstanding with no adjustments to net income available to common

stockholders for potentially dilutive common shares.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in millions, except share or per share amounts)			
Diluted earnings per share				
Net income available for common stockholders	\$ 39	\$ 31	\$ 126	\$ 78
Weighted average shares of common stock outstanding				
Class A				
Issued and outstanding	74,649,369	71,109,477	72,878,907	69,405,524
Potentially dilutive common shares				
Issuable pursuant to employee stock incentive plans	710,620	863,906	866,633	1,003,995
Class B	100	100	100	100
	75,360,089	71,973,483	73,745,640	70,409,619
Diluted earnings per share	\$ 0.51	\$ 0.43	\$ 1.71	\$ 1.10

#### Member Distributions and Stockholder Dividends

During the nine months ended September 30, 2018, IBG LLC made distributions totaling \$376 million, to its members, of which IBG, Inc.'s proportionate share was \$66 million. In March, June and September 2018, the Company paid quarterly cash dividends of \$0.10 per share of common stock, totaling \$7 million, \$7 million and \$8 million respectively.

On October 16, 2018, the Company declared a cash dividend of \$0.10 per common share, payable on December 14, 2018 to stockholders of record as of November 30, 2018.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

## 5. Comprehensive Income

The following table presents comprehensive income and earnings per share on comprehensive income:

	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
	(in millions, except share or per share amounts)			
Comprehensive income available for common stockholders	\$ 38	\$ 32	\$ 113	\$ 89
Earnings per share on comprehensive income				
Basic	\$ 0.51	\$ 0.45	\$ 1.55	\$ 1.28
Diluted	\$ 0.50	\$ 0.44	\$ 1.54	\$ 1.26
Weighted average common shares outstanding				
Basic	74,649,469	71,109,577	72,879,007	69,405,624
Diluted	75,360,089	71,973,483	73,745,640	70,409,619

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

## 6. Financial Assets and Financial Liabilities

## Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables set forth, by level within the fair value hierarchy (see Note 2), financial assets and liabilities, measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017. As required by ASC Topic 820, financial assets and financial liabilities are classified in their entirety based on the lowest level of input that is significant to the respective fair value measurement.

Financial Assets At Fair Value  
as of September 30, 2018

	Level 1	Level 2	Level 3	Total
	(in millions)			
Securities segregated for regulatory purposes	\$ 4,098	\$ —	\$ —	\$ 4,098
Financial instruments owned, at fair value				
Stocks	632	—	1	633
Options	1,720	—	—	1,720
Warrants	—	—	—	—
U.S. and foreign government securities	230	—	—	230
Corporate and municipal bonds	—	2	3	5
Currency forward contracts	—	—	—	—
Total financial instruments owned, at fair value	2,582	2	4	2,588
Total financial assets at fair value	\$ 6,680	\$ 2	\$ 4	\$ 6,686

Financial Liabilities At Fair  
Value as of September 30,  
2018

Level 1	Level 2	Level 3	Total
---------	---------	---------	-------

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

(in millions)

Financial instruments sold, but not yet purchased, at fair value				
Stocks	\$ 215	\$ —	\$ —	\$ 215
Options	689	—	—	689
Currency forward contracts	—	11	—	11
Total financial instruments sold, but not yet purchased, at fair value	904	11	—	915
Total financial liabilities at fair value	\$ 904	\$ 11	\$ —	\$ 915



Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Financial Assets At Fair Value				
as of December 31, 2017				
	Level 1	Level 2	Level 3	Total
(in millions)				
Securities segregated for regulatory purposes	\$ 4,519	\$ —	\$ —	\$ 4,519
Financial instruments owned, at fair value				
Stocks	2,000	—	1	2,001
Options	1,052	—	—	1,052
Warrants	5	—	—	5
U.S. and foreign government securities	60	—	—	60
Corporate and municipal bonds	—	1	3	4
Currency forward contracts	—	32	—	32
Total financial instruments owned, at fair value	3,117	33	4	3,154
Total financial assets at fair value	\$ 7,636	\$ 33	\$ 4	\$ 7,673

	Financial Liabilities At Fair Value as of December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Financial instruments sold, but not yet purchased, at fair value				
Stocks	\$ 302	\$ —	\$ —	\$ 302
Options	464	—	—	464
Currency forward contracts	—	1	—	1
Total financial instruments sold, but not yet purchased, at fair value	766	1	—	767
Total financial liabilities at fair value	\$ 766	\$ 1	\$ —	\$ 767
Transfers between Level 1 and Level 2				

Transfers of financial assets and financial liabilities at fair value to or from Levels 1 and 2 arise where the market for a specific financial instrument has become active or inactive during the period. The fair values transferred are ascribed as if the financial assets or financial liabilities had been transferred as of the end of the period. During the nine months ended September 30, 2018 and 2017, there were no transfers between levels for financial assets and liabilities, at fair value, respectively.

#### Level 3 Financial Assets and Financial Liabilities

The Company's Level 3 financial assets are comprised of delisted and illiquid securities reported within financial instruments owned, at fair value in the condensed consolidated statements of financial condition. As of September 30, 2018, Level 3 financial assets included \$1 million in stocks and \$3 million in corporate and municipal bonds, which were not traded in active markets and were valued by the Company based on internal estimates. During the nine months ended September 30, 2018 and 2017, there were no transfers between levels for financial assets and liabilities, at fair value, respectively.

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Trading Gains from Market Making Transactions

Trading gains and losses from market making transactions reported in the condensed consolidated statements of comprehensive income, by major product type, are comprised of:

	Three Months Ended September 30, 2018 2017		Nine Months Ended September 30, 2018 2017	
	(in millions)			
Equities	\$ 7	\$ 9	\$ 32	\$ 29
Foreign exchange	—	2	—	(3)
Total trading gains, net	\$ 7	\$ 11	\$ 32	\$ 26

These transactions are related to the Company's financial instruments owned and financial instruments sold, but not yet purchased, at fair value and include both derivative and non-derivative financial instruments, including exchange traded options and futures. These gains and losses also include market making related dividend income and expense.

Financial Assets and Liabilities Not Measured at Fair Value

The following tables represent the carrying value, fair value, and fair value hierarchy category of certain financial assets and liabilities that are not recorded at fair value in the Company's condensed consolidated statements of financial condition. The following table excludes certain financial instruments such as equity investments and all non-financial assets and liabilities:

		September 30, 2018		
Carrying Value	Fair Value	Level 1	Level 2	Level 3

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

(in millions)

Financial assets, not measured at fair value					
Cash and cash equivalents	\$ 3,062	\$ 3,062	\$ 3,062	\$ —	\$ —
Cash - segregated for regulatory purposes	7,523	7,523	7,523	—	—
Securities - segregated for regulatory purposes	8,734	8,734	—	8,734	—
Securities borrowed	3,551	3,551	—	3,551	—
Securities purchased under agreements to resell	331	331	—	331	—
Receivables from customer	30,913	30,913	—	30,913	—
Receivables from broker, dealers, and clearing organizations	846	846	—	846	—
Interest receivable	117	117	—	117	—
Other assets	5	6	—	6	—
Total financial assets, not measured at fair value	\$ 55,082	\$ 55,083	\$ 10,585	\$ 44,498	\$ —

Financial liabilities, not measured at fair value					
Short-term borrowings	\$ 28	\$ 28	\$ —	\$ 28	\$ —
Securities loaned	3,834	3,834	—	3,834	—
Securities sold under agreements to repurchase	—	—	—	—	—
Payables to customer	49,823	49,823	—	49,823	—
Payables to brokers, dealers and clearing organizations	179	179	—	179	—
Interest payable	35	35	—	35	—
Total financial liabilities, not measured at fair value	\$ 53,899	\$ 53,899	\$ —	\$ 53,899	\$ —

Table of Contents

Interactive Brokers Group, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

	December 31, 2017				
	Carrying	Fair			Level
	Value	Value	Level 1	Level 2	3
	(in millions)				
Financial assets, not measured at fair value					
Cash and cash equivalents	\$ 1,732	\$ 1,732	\$ 1,732	\$ —	\$ —
Cash - segregated for regulatory purposes	6,547	6,547	6,547	—	—
Securities - segregated for regulatory purposes	9,166	9,166	—	9,166	—
Securities borrowed	2,957	2,957	—	2,957	—
Securities purchased under agreements to resell	2,035	2,035	—	2,035	—
Receivables from customer	29,821	29,821	—	29,821	—
Receivables from broker, dealers, and clearing organizations	823	823	—		