



# **INTERACTIVE BROKERS (U.K.) LIMITED**

FCA REGISTRATION NUMBER 208159

COMPANY NUMBER 03958476

## **Pillar 3 Disclosures**

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**2019**

# Contents

<b>1. Introduction.....</b>	<b>3</b>
<b>1.1. Background.....</b>	<b>3</b>
<b>1.2. Frequency and Scope of Disclosures.....</b>	<b>3</b>
<b>1.3. Company Overview .....</b>	<b>4</b>
<b>2. Risk Management Objectives and Policies.....</b>	<b>6</b>
<b>2.1. Governance Structure Overview .....</b>	<b>6</b>
<b>2.2. Overall Risk Statement and Appetite .....</b>	<b>7</b>
<b>2.3. Risk Assessment Approach .....</b>	<b>7</b>
<b>3. Capital Resources .....</b>	<b>8</b>
<b>3.1. Capital Management and Dividends .....</b>	<b>8</b>
<b>3.2. Own Funds and Regulatory Capital Requirements .....</b>	<b>8</b>
<b>3.3. Pillar 2 Risks.....</b>	<b>8</b>
<b>3.4. Internal Capital Adequacy Assessment Process (ICAAP) .....</b>	<b>8</b>
<b>4. Principal Risks.....</b>	<b>10</b>
<b>4.1. Credit Risk.....</b>	<b>10</b>
<b>4.2. Market Risk.....</b>	<b>10</b>
<b>4.3. Operational Risk .....</b>	<b>11</b>
<b>4.4. Liquidity Risk.....</b>	<b>12</b>
<b>5. Remuneration Policy Disclosures .....</b>	<b>13</b>
<b>5.1. Decision Making Process for Determining Remuneration Policy .....</b>	<b>13</b>
<b>5.2. Code Staff Criteria .....</b>	<b>13</b>
<b>5.3. Link between Pay and Performance .....</b>	<b>13</b>
<b>5.4. Remuneration Cost for Code Staff.....</b>	<b>14</b>

# 1. Introduction

## 1.1. Background

This Pillar 3 disclosure for Interactive Brokers (U.K.) Limited ('IBUK' or 'the Firm') is prepared in accordance with the EU's Capital Requirements Regulation ('CRR') and Capital Requirements Directive ('CRD'), together referred to as 'CRD IV', as implemented by the Financial Conduct Authority ('FCA').

Pillar 3 disclosures are intended to increase confidence in the financial markets through market participants review of key information relating to a firm's capital adequacy, risk exposures and risk management framework.

The regulatory framework established by CRD consists of three 'Pillars':

- Pillar 1 defines the minimum capital required to meet a firm's credit, market and operational risk;
- Pillar 2 ensures that a firm has sufficient capital to support the risks not fully captured by the minimum capital requirements, in accordance with the firm's internal assessment; and
- Pillar 3 requires firms to make public disclosures of certain specific information concerning capital, risk exposures and risk management arrangements.

The disclosures made in this document meet IBUK's obligation with respect to Pillar 3 and the requirements outlined in Articles 431-455 of the CRR. A detailed assessment of the requirements under Pillars 1 and 2 has been completed through IBUK's Internal Capital Adequacy Assessment Process ('ICAAP').

## 1.2. Frequency and Scope of Disclosures

The disclosures made in this document are in respect of IBUK, which is an IFPRU 730k Limited Activity firm and are for the 52 week financial reporting period ended 31<sup>st</sup> December 2019.

IBUK publishes its Pillar 3 disclosures at least annually in conjunction with the date of publication of the financial statements. The disclosures are published on IBUK's website ([www.interactivebrokers.co.uk](http://www.interactivebrokers.co.uk) on the page 'forms and disclosures'). Given the scale, complexity and range of its activities, IBUK's Board concluded that publishing the disclosures annually is sufficient.

IBUK's Pillar 3 disclosures comply with guidance in CRR Article 432 which states that a firm may omit one or more of the disclosures if the information provided by such disclosures is either: (a) not material, (b) regarded as proprietary or (c) confidential.

- Information in disclosures is regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.
- Information is regarded as proprietary if disclosing it publicly would undermine its competitive position.
- Information is regarded as confidential if there are obligations to customers or other counterparty relationships binding an institution to confidentiality.

These disclosures have been prepared solely for the purpose of fulfilling the Firm's Pillar 3 disclosure requirements and are not used by management for any other purpose. They have not been audited nor do they constitute any form of audited financial statement.

### 1.3. Company Overview

#### **Interactive Brokers (U.K.) Limited**

IBUK operates both as a broker, executing and clearing orders for its clients, and as a broker-dealer for certain financial products. Clients include affiliated companies. The Firm does not take proprietary positions for its account, except on a matched principal basis to support its brokerage business with clients. Principal positions resulting from facilitating client business are offset with counterparties. The Firm does not provide research, dispense advice or execute discretionary orders. The Firm does not engage in investment banking or underwriting.

IBUK maintains a highly liquid balance sheet and has established procedures for measuring funding requirements and monitoring its capital. IBUK has historically been profitable and maintains significant excess regulatory capital. The Firm relies on its own capital for regulatory and liquidity needs. However, as a subsidiary under the overall control of Interactive Brokers Group, Inc. (together with its consolidated subsidiaries, collectively, 'IB Group' or 'Group') IBUK has access to additional liquidity and capital from its indirect parent, IBG LLC. The majority of the Firm's assets represent collateralised receivables from clearing houses for settlement of securities and derivative transactions and receivables from banks and counterparties.

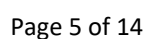
IBUK carries direct clients and holds client money and safe custody assets, which it protects in accordance with the FCA's CASS regulations.

#### **Interactive Brokers Group Inc. Structure: Legal and Operational**

IBUK is part of a global group of financial services companies that are under the common control of IB Group. IB Group is publicly listed in the U.S. on the NASDAQ exchange, under the ticker symbol IBKR. Public shares account for approximately 18.5% of the total ownership of the Group, and the remainder is majority owned by Mr. Thomas Peterffy, the founder, and his affiliates.

IB Group is an automated global electronic broker and market maker (although, it has substantially exited the options market making business). IB Group services accounts for hedge and mutual funds, registered investment advisors, proprietary trading groups, introducing brokers and individual investors. It specializes in routing orders while striving to achieve best executions and processing trades in stocks, options, futures, foreign exchange instruments, bonds, mutual funds and exchange traded funds on more than 135 electronic exchanges and market centres around the world. IB Group's headquarters are in Greenwich, Connecticut, USA.

IB Group maintains a conservative capital structure with a low level of debt and a highly liquid balance sheet. The Group has grown organically and can trace its origins back over four decades. After the Group's initial public offering in May 2007, IB Group capital has grown from approximately \$2.9 billion to \$7.9 billion at the end of 2019, with no long-term debt.



## 2. Risk Management Objectives and Policies

### 2.1. Governance Structure Overview

The Board of IBUK (the “Board”) is the governing body for managing risk within the Firm, although a significant majority of Risk Management functions are centralised for the IB Group.

The following committees advise the Board:

- Nomination Committee, which assesses the performance and membership of the Board;
- Remuneration Committee, which is responsible for the framework of remuneration for IBUK’s executives; and
- Risk Committee, which has oversight of the Firm’s risk appetite and exposures.

At a higher level, the risk management strategy for the Group is set by the Steering Committee for IB Group, a group of senior executives representing all parts of the Group’s business. The principal matters addressed by the IB Group Steering Committee are:

- To set the strategic direction for risk management within the Group;
- To set the control structure for the Group;
- To delegate authority to other Group entities; and
- To define and communicate the risk appetite of the Group.

Members of Group management are accountable for the operation of the systems of internal control within the Group’s core businesses.

The Group’s governance structures for risk management are based on the three lines of defence model:

- Primary accountability for managing risk lies with the management teams within each business area;
- The second line of defence is provided by those specialist functions that undertake policy setting and monitoring and analysis roles, such as Compliance, Treasury, Accounting and Financial Regulation; and
- The third line of defence is provided by Internal Audit, which has responsibility for providing independent assurance over the risk management process and the internal controls environment.

IBUK’s own funds, liquidity and risk planning are integrated and IBUK Board members participate in Group level governance structures. The entire group, along with IBUK, follows the philosophy of being fiscally conservative and staying prepared for market dislocations. To this end, the Firm and the Group undertake only business projects that are well within their capital means.

## 2.2. Overall Risk Statement and Appetite

The Board of IBUK sets the overall level of risk that the Firm will accept. The level of risk is always subject to approval by the Group Steering Committee.

IBUK takes risks to earn revenue in the markets in which it operates, as with all companies. The Board believes that the correct approach to follow is that the only risks to which IBUK is exposed are ones that are fully understood and which are monitored to ensure that overexposure does not occur.

The approach of IBUK to risk management is to have procedures in place which embed risk management in the culture of the organisation, clearly identifying risk exposures and implementing processes, automated if possible, to minimise those risks.

## 2.3. Risk Assessment Approach

Risks are assessed by IBUK in terms of how likely they are to occur and the magnitude of the consequences if they were to happen. Having assessed the risks, the Firm selects one of the following approaches:

- Tolerate the risk - The ability to take effective action against some risks may be limited, or the cost of mitigation may be disproportionate to the potential benefit. In this instance, the only management action required is to monitor the risk, identifying the likelihood or impact of exposure, and, where appropriate, promptly escalate action toward mitigation or termination.
- Mitigate the risk - The purpose of mitigation is to manage the risk to an acceptable level.
- Terminate the risk - This involves decisive action to eliminate a risk altogether.

IBUK management believes that the establishment and operation of this policy has ensured that the level of risk across the business is acceptable.

It is important to note that both IBUK and the Group have a low tolerance for risk. IBUK and IB Group utilise the same internationally deployed real-time automated systems to monitor and curtail risks.

### 3. Capital Resources

#### 3.1. Capital Management and Dividends

IBUK's policy is to use its earnings to fund growth. Historically no dividends have been paid out and there are no plans to make dividend payments in the next twelve months. The use of the Firm's earnings to fund its expansion and build its capital reserves promotes confidence in the financial and capital strength of the business and its ability to withstand future shocks.

Notwithstanding the above, the Group is fully committed to providing additional capital for IBUK if it is needed.

#### 3.2. Own Funds and Regulatory Capital Requirements

	31 Dec 19 £'m	31 Dec 18 £'m
Shareholder's Equity Per Audited Financial Statements	121.0	106.2
<b>Common Equity Tier 1 Capital</b>	<b>121.0</b>	<b>106.2</b>
Tier 2 Capital	0.0	0.0
<b>Total Regulatory Capital Resources/ Own Funds (CR)</b>	<b>121.0</b>	<b>106.2</b>
Credit Risk Capital Requirement	8.5	4.7
Credit Valuation Adjustment Capital Requirement	0.4	0.3
Market Risk	1.0	0.6
Fixed Overhead Requirement	3.3	2.2
<b>Total (Pillar 1) Capital Requirement (CRR)</b>	<b>13.2</b>	<b>7.8</b>
<b>Total Pillar 1 Risk Weighted Assets</b>	<b>164.6</b>	<b>97.5</b>
Surplus CR over CRR	<b>107.8</b>	<b>98.4</b>
<b>Total Own Funds Capital Ratio (%)</b>	<b>73.5%</b>	<b>108.9%</b>

IBUK has adopted the standardised approach for Credit Risk (CRR, Articles 111-141 & 274) and the CVA (CRR Article 384). The Market Risk is calculated according to CRR Articles 325-377.

As an IFPRU investment firm, IBUK's Tier 1 Capital requirements are the greater of its base capital requirement of EUR730,000 or the sum of its Credit, Operational and Market Risk requirements.

#### 3.3. Pillar 2 Risks

Pillar 2 requires firms to assess the amount of internal capital they consider adequate to cover the risks to which they are, or are likely to be, exposed to in addition to those risks covered by Pillar 1. It also requires firms to consider the costs associated with winding down the firm and various stress scenarios.

Pillar 2 capital requirements are outside the scope of this disclosure document.

#### 3.4. Internal Capital Adequacy Assessment Process (ICAAP)

The IBUK Board undertakes an internal assessment of capital requirements via the ICAAP and supporting stress tests at least annually. The ICAAP is the process of identification, measurement,



management and monitoring of risks to the business and the adequacy of internal capital. This was last approved by members of the Board in June 2019.

In addition, the ICAAP is embedded in IBUK's risk management process and may be periodically updated throughout the year with regard to identified risks and with current financial data.

## 4. Principal Risks

IBUK's principal business activities result in exposure to the major risks described below.

The Board believes that the most significant risk faced is Credit Risk. The other risks noted below are likely to have a minimal impact on IBUK, either due to its business model or because of mitigating actions.

### 4.1. Credit Risk

Credit Risk for IBUK is the most significant risk on a day-to-day basis, and so management of credit risk exposures is, therefore, a core process for IBUK and the Group. It comes in two main forms: (1) the extension of credit to customers (ie trading on margin), and (2) limited risk on receivables from counterparties. The former is managed principally by the establishment and operation of margining rules, and by the continuous automated monitoring of credit exposures. The latter is managed by the Firm's credit policies and procedures. More specifically, the risks IBUK captures under credit risk are:

- A bank will be unable to repay the monies deposited with it;
- A market counterparty through which the Firm hedges its exposures will be unable to settle the deals made through it or to repay the monies that it is holding on the Company's account;
- Deposits with a clearing house are frozen;
- A client, including an affiliate, is unable to make good a deficit on his account brought about by incurring losses at such a rate that the margin held on the account proves to be insufficient; or
- A major credit failure - which is considered by the Board to be the largest threat to the short-term future of the business, due to the potential size of a loss.

The assessment of the Board of IBUK of its credit risk exposure is that:

- IBUK's credit risk is diversified with the exceptions of banks, market counterparties and affiliates, where credit risk is currently assessed as limited.
- Automated controls in place and margining policies set for individual clients ensure that credit risk is minimal, although limited exposure to a credit failure is accepted as unavoidable in such a business.

### 4.2. Market Risk

Market Risk within IBUK is tightly managed as the Firm does not take proprietary positions, although at any time it may carry a small amount, compared to its capital, of foreign exchange exposure. The most significant market risk therefore, would be if the hedging strategies adopted prove to be flawed.

Currently, the Firm's exposure to market risk is minimal. The Firm does not hold proprietary positions in financial instruments, except for those arising through facilitating client transactions, which are risk-reducing in nature.

For its riskless principal business offering CFDs, trades generated by IBUK's client base are automatically booked against a counterparty so that net exposures at IBUK are always flat.

The area where IBUK is exposed to market risk is in foreign currency. IBUK's exposure to fluctuations in the relative value of foreign currencies against sterling is minimal and arises from the fact that the Firm collects commissions and pays expenses in various currencies. To address this the Firm actively manages its foreign currency assets and liabilities to make sure they are in balance.

IBUK's assessment of its market risk exposure is that overall market risk is low due to the business model of the Company and the products offered.

#### 4.3. Operational Risk

Operational Risks that IBUK is exposed to are:

- Financial Risk - Our accounting system operates with automated data feeds from clearing and banking systems, allowing us to produce financial statements for all parts of our business every day by mid-day on the business day following trade date.
- People Risk - Employees are recruited in accordance with documented procedures, including tests where relevant, with references taken on every occasion. Employees are appraised on an annual basis. Cross training is implemented in each sector of the business wherever possible. The development of automated processes throughout the business also serves to mitigate IBUK's exposure to people risk.
- IT Risk - Our technical operations team continuously monitors our network and the proper functioning of each of our nodes (exchanges and market centers, internet service providers ("ISPs"), leased customer lines and our own data centers) around the world.
- Legal and Compliance Risk - Our Compliance Department supports and seeks to ensure proper operations of our electronic brokerage in accordance with applicable regulatory requirements. The philosophy of the Compliance Department, and the Firm as a whole, is to build automated systems to try to minimize manual steps in the compliance process and then to augment these systems with experienced staff members who apply their judgment where needed. We have built automated systems to handle wide-ranging compliance issues such as trade and audit trail reporting, financial operations reporting, enforcement of margin rules and review of employee correspondence, archival of required records, execution quality and order routing reports, approval and documentation of new customer accounts, and anti-money laundering and anti-fraud surveillance. Our automated operations and automated compliance systems provide substantial efficiencies to our Compliance Department. Nonetheless, we have increased our Compliance staffing over the past several years to meet the increased regulatory burdens faced by all industry participants.
- Clearing and Settlement Risk - Our clearing system reconciles trade executions in real-time and performs end of day reconciliation of positions, allowing us to effectively manage operational risk. We operate in a CCP environment for all products that IBUK carries except CFDs and unallocated metals, which are conducted on a principal to principal basis.

The Board has concluded that the level of risk across the business is acceptable under the current policies and continuous functioning of the operational controls. The Firm continuously monitors and improves its operational controls.

#### 4.4. Liquidity Risk

Liquidity Risk is the risk a firm (although solvent) either does not have enough financial resources to meet its obligations, or that the cost to secure such resources is only available at an excessive cost.

The level of liquidity risk that IBUK faces has been assessed as very low due to the excess capital available within the business.

IBUK must fund the following actions/events:

- Settlements of securities and derivatives transactions.
- Margin requirements by the clearing houses and market counterparties.
- Losses incurred by clients in excess of the equity they have placed with the firm.

Historically, liquidity has not been a constraint for IBUK and management believes the Company has enough resources to meet all its anticipated liquidity needs for the next twelve months.

As of 31 December 2019:

- The Firm's receivables are reviewed on a regular basis to ensure that all obligations are met on a timely manner. IBUK maintains a highly liquid balance sheet. Approximately 99% of assets mature in less than one month. Any past due receivables are reported to management immediately.
- IBUK's net fixed assets and other assets not readily realizable constitute less than 3% of its equity capital. The rest of firm's assets were considered liquid.

In addition to its capital, IBUK has access to significant liquidity resources from the Group. These resources are comprised of material excess capital at other Group affiliates, uncommitted secured and unsecured bank lines and securities lending relationships.

IBUK's assessment of the liquidity risk it faces and how it is addressed is considered in the ICAAP. The Board assesses the Firm's exposure to liquidity risk as limited.

## 5. Remuneration Policy Disclosures

IBUK, as an FCA authorised and regulated IFPRU limited activity firm is subject to the FCA's rules on remuneration, which are located in the Systems and Controls (SYSC 19) of the FCA Handbook as well as Article 450 of the CRR. The Remuneration Code (the 'Code') covers an employee's total remuneration, fixed and variable. IBUK incentivizes staff through a combination of the two.

Our remuneration policies, which are designed to ensure that we comply with the Code and IB Group's compensation arrangements:

- Are consistent with and promotes sound and effective risk management;
- Do not encourage excessive risk taking;
- Include measures to avoid conflicts of interest; and
- Are in line with IBUK's business strategy, objectives, values and long-term interests.

EU remuneration provisions and disclosures recognise that not all the Code's provisions apply to all firms equally and introduce a concept of proportionality relative to a firm's size, internal organisation and the nature, scope and complexity of their activities. The FCA has applied proportionality by categorizing firms into three levels. IBUK falls within the FCA's proportionality level three and this disclosure meets the requirements for level three firms.

### 5.1. Decision Making Process for Determining Remuneration Policy

IBUK's policy is in line with the Code's principals set out by the FCA. IBUK applies an enterprise-wide approach to its remuneration policies and practices. IBUK's policy will be reviewed as part of the annual process and procedures, or following a significant change to the business requiring an update to its internal capital adequacy assessment.

IBUK's ability to pay bonuses is based on the performance of IBUK and the Group overall.

### 5.2. Code Staff Criteria

IBUK considers all employees who undertake Senior Management Functions (as defined by the FCA) as Code Staff. As at 31 December 2019 the number of Code Staff was four.

### 5.3. Link between Pay and Performance

IBUK's remuneration policy links pay and performance to achieve effective risk management, avoid conflicts of interest and to align with IBUK's business strategy as follows:

- Employees are rewarded based on their contribution to the overall strategy of the business. Other factors such as performance, reliability, effectiveness of controls, as well as business development and departmental requirements in line with IBUK's long-term interests and objectives, are taken into account when assessing the performance of the senior staff.

- Employees are remunerated by the means of fixed pay, including pension and benefits, and variable remuneration which consists of an annual performance-related bonus.
- IBUK's key employees (including Code Staff) participate in the IB Group Stock Incentive Plan, which is a scheme introduced to align employee interests with shareholder interests over the long term. Employees are awarded restricted stock units in IBUK's overall parent company, IBG Inc. (ticker symbol NASDAQ:IBKR). The stock units have various vesting provisions and generally convert to common stock over seven years. Such units are restricted from sale, transfer or assignment until the end of the restriction period.

#### 5.4. Remuneration Cost for Code Staff

IBUK has decided for reasons of the proprietary nature of remuneration not disclose this information for its Code Staff, as permitted under CRR Article 432.