



## INTERACTIVE BROKERS LLC

A Member of the Interactive Brokers Group  
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David M. Battan  
Executive Vice President and General Counsel

May 23, 2016

### MEMORANDUM

Re: Due Diligence Information for Advisors, Brokers, Hedge Funds and Other Financial Institutions and Intermediaries Using or Considering Interactive Brokers LLC as Prime Broker/Custodian

This memorandum sets forth relevant due diligence information for advisors, brokers, hedge funds and other financial institutions and intermediaries using or considering Interactive Brokers LLC (“IB LLC”) as their prime broker/custodian.

Based on its strong financial position, close regulatory oversight, conservative and experienced management, worldwide best execution technology and low cost, Interactive Brokers is increasingly the first choice for prime brokerage and clearing and custody services for global financial advisors, funds, introducing brokers and other investment professionals.

Custodying with Interactive Brokers will also give you the best possible access to our full range of services, including services and pricing options not available to clients who carry their assets elsewhere.

#### Regulatory Financials and Credit Rating:

Interactive Brokers LLC is a subsidiary of the Interactive Brokers Group, a publicly traded company listed on the Nasdaq Stock Exchange under the symbol “IBKR” with a market capitalization of *over \$15 billion*.<sup>1</sup>

As of March 31, 2016, IB LLC, our U.S broker-dealer, had regulatory net capital of *over \$2.6 billion* USD, and *excess net capital of nearly \$2.4 billion* (i.e., the capital maintained by IB LLC to satisfy its obligations to its clients and counterparties was over \$2 billion USD more than required by our U.S. regulators (the U.S. Securities and Exchange Commission (“SEC”) and the U.S. Commodity Futures Trading Commission (“CFTC”))).

IB LLC is rated “BBB+ (Stable)” by Standard & Poor’s. The firm’s global independent auditors are Deloitte & Touche.

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<sup>1</sup> Approximately 85% of IBG is privately held by company management and employees. As a result, the market capitalization of IBG’s publicly traded shares is approximately \$2.4 billion.

### NYSE Membership and Global Regulatory Oversight:

IB LLC is a member of the New York Stock Exchange and has been a registered broker-dealer with the U.S. SEC since 1994. IB LLC is currently licensed with and regulated by at least 16 self-regulatory organizations worldwide and 52 U.S. states and territories. Among other agencies, IB LLC is licensed and regulated by the SEC, CFTC, the U.S. Financial Industry Regulatory Authority (“FINRA”), the U.S. National Futures Association (“NFA”), the Hong Kong Securities and Futures Commission and the U.K. Financial Conduct Authority. IB LLC is also a clearing member of the Options Clearing Corporation, the Depository Trust Company and the National Securities Clearing Corporation. IB LLC and its affiliates are members of roughly ***120 exchanges, clearinghouses and trading venues worldwide.***

### SIPC Membership, Excess SIPC Coverage from Lloyd’s of London, and Segregation and Protection of Assets

Interactive Brokers LLC is a member of the Securities Investor Protection Corporation (“SIPC”) and client assets held with IB LLC are protected by SIPC. Maximum SIPC coverage is \$500,000 (with a cash sublimit of \$250,000). In addition, IB LLC has obtained an excess SIPC insurance policy for the benefit of its clients with certain underwriters at Lloyd's of London for up to an additional \$30 million (with a cash sublimit of \$900,000) subject to an aggregate limit of \$150 million.

IB LLC is subject to strict “reserve” and “segregation” requirements imposed by the SEC and the CFTC, under which cash in IB LLC client accounts is kept in segregated accounts that are entirely separate from the proprietary assets of IB LLC. IB LLC is required to perform daily calculations to ensure that the proper amount of client funds is set aside in these separate accounts. Under new, industry-wide rules recently passed in the U.S., some of IB LLC’s regulators even have direct, independent access to monitor IB’s segregated customer bank accounts to ensure that they contain the amounts reported by IB.

Under U.S. law, client stock not held on margin is held in segregated depository accounts at the Depository Trust Company in the U.S. or, outside the U.S., in equivalent “good control locations” under SEC rules.

Under SEC regulations, stock that clients hold on margin can be lent to other financial institutions (for example, to facilitate short selling). These stock loans are at least 100% collateralized by cash from those institutions that is received by IB LLC and then placed in the segregated Reserve Safekeeping Accounts for the exclusive benefit of IB clients.

Margin funds given to IB LLC by clients to margin futures trades or option trades are deposited by IB LLC in segregated client-benefit accounts with the relevant clearinghouses (*e.g.*, The Options Clearing Corporation or the CME Clearing House), or, for non-U.S. contracts, with an approved foreign clearinghouse or clearinghouse member. Clearinghouses eliminate direct counterparty risk in futures and options contracts by centralizing clearing and settlement of the

contracts so that the clearinghouses (and not the exchange members) guarantee performance on the winning contracts.

As noted, IB LLC client cash is held in segregated accounts designated as exclusively for the benefit of IB LLC customers. These deposits currently are distributed across more than ten banks with investment-grade ratings so that we can avoid a concentration risk with any single institution. Client cash is also invested in U.S. Treasury securities held for the benefit of clients, including direct investments in short-term Treasury bills and reverse repurchase agreements, where the collateral received is in the form of U.S. Treasury securities. These transactions are conducted with third parties and guaranteed through a central counterparty clearinghouse (Fixed Income Clearing Corp., or “FICC”). The collateral remains in the possession of IB and is also held at a custody bank in a segregated Reserve Safekeeping Account for the exclusive benefit of clients.

The above system of protections and checks and balances is monitored on a daily, weekly and monthly basis by IB LLC systems and senior management. In addition, IB LLC is audited by its own Internal Audit Department, its independent outside auditors Deloitte & Touche LLP, and at least annually by FINRA, NFA and other self-regulatory organizations.

Note that in the unlikely event that a SIPC member firm fails, customers have special priority over other unsecured creditors in distributions of customer property (unlike in an ordinary bankruptcy). In such an event, SIPC generally steps in immediately and asks a U.S. federal court to appoint a trustee to liquidate the firm and protect its customers. The fact that customer securities and cash are kept in segregated accounts (separate from the broker-dealer’s proprietary positions) facilitates this process. Normally, the trustee will first try to have some or all customer accounts transferred from the failed broker-dealer to another SIPC member broker-dealer. If the trustee is unable to transfer customer accounts, the trustee tries to satisfy claims on an individual basis after the customer files his or her claim with the trustee.

#### Protection for Clients of Advisors, Brokers and Other Financial Intermediaries

The SIPC and client asset protections described above under U.S. law apply to ***all customer assets held with IB LLC***, regardless of the country of origin of the customer. The protections apply to separately managed accounts managed for clients by U.S. and global independent financial advisors and also to fully disclosed customer accounts that are introduced to IB LLC by U.S. and global introducing/correspondent brokers. The protections also apply to non-disclosed and omnibus accounts held with IB LLC that contain assets of customers of an introducing broker (although please note that under U.S. law, *proprietary* assets of introducing brokers are protected under separate rules than *customer* assets of introducing brokers). The protections also apply to all customers and customer assets introduced to IB LLC by its foreign affiliates such as Interactive Brokers (U.K.) Limited.

## Interactive Brokers Senior Management and its Legal and Compliance and Internal Audit Departments

The first broker-dealer in the Interactive Brokers Group was founded 40 years ago by Thomas Peterffy, who remains the Chairman and CEO. The senior management of Interactive Brokers holds a substantial majority ownership interest in the business, which is reflected in the conservative manner in which the business is managed and operated. The average tenure of IB's executive management team is 30 years with the company.

Interactive has a large and experienced compliance staff. The firm and its affiliates currently employ more than 80 full-time compliance and legal personnel to ensure that IB and its clients are following required rules and regulations. The firm's compliance staff includes executives who have held senior positions at the SEC, the CFTC and FINRA. The firm also maintains a robust Internal Audit Department led by its Chief Audit Executive, who has 20 years experience in the industry.

## Interactive Brokers' Excellent Disciplinary Record

Interactive Brokers LLC has an excellent disciplinary record. In the past several years, regulators worldwide have been extremely aggressive in bringing regulatory actions and imposing fines on firms in the financial industry even for minor administrative matters. However, IB has had far fewer citations for regulatory violations and has paid many fewer fines than our competitors in the prime brokerage and custody industry:

<b>Company</b>	<b>FINRA Broker Check Regulatory Violations and Disclosure Events 2010-Present</b>	<b>Approx. Total Fines/Payments</b>
Merrill Lynch, Pierce, Fenner & Smith Incorporated	190	\$301,386,064
Citigroup Global Markets Inc.	142	\$155,634,764
UBS Securities LLC	125	\$115,222,968
J.P. Morgan Securities LLC	117	\$201,598,984
Morgan Stanley & Co. LLC	106	\$145,769,452
E*Trade Securities LLC	64	\$8,234,032

Wedbush Securities Inc.	43	\$7,066,041
TD Ameritrade, Inc.	36	\$13,660,800
Goldman Sachs Execution & Clearing, L.P.	32	\$10,796,750
Interactive Brokers LLC	19	\$2,739,500

### Global Scale and Access

IB LLC is the largest brokerage firm in the United States as measured by Daily Average Revenue Trades. In April 2016, the firm conducted an average of 662,000 trades each day worldwide. IB LLC serves more than 348,000 clients, who keep over \$71 billion in equity at IB. IB LLC and its affiliates trade on over 100 market centers in 24 countries and provide direct market access to stocks, options, futures, forex, bonds, metals, ETFs and CFDs. The firm allows its clients to maintain funds and conduct trading in at least 18 different currencies.

### Best Execution

Interactive Brokers does not sell its order flow to another broker to handle and route. Instead, IB has built a real-time, high-speed Best Execution Order Routing System (“IB SmartRouting”), which is designed to optimize execution price, speed and total cost of execution for stocks and options. IB constantly changes and enhances the SmartRouting system to adapt to changes in markets, new exchanges, new trading rules, etc. IB's SmartRouting system continually scans competing market centers and automatically seeks to route orders to the best market, taking into account factors such as quote size, quote price, exchange or Automated Trading Systems (“ATS”) transaction fees or rebates and the availability of price improvement (execution at a better price than the National Best Bid or Offer (“NBBO”). The IB SmartRouting system continually reevaluates market conditions and prices for pending IB client orders and dynamically re-routes orders as necessary.

***The quality of IB’s U.S. stock and option executions has outperformed the industry as a whole for at least nine straight years*** based on independent measurements by the Transaction Auditing Group, Inc., a third-party provider of transaction analysis. In the most recent period for which data is available, IB client orders received prices 10 cents better per 100 shares than the industry average for U.S. stock orders and 27 cents per contract better for U.S. options than the industry average.

Interactive Brokers is alone in the U.S. brokerage industry in calculating and publishing total cost of execution statistics, which take into account both commissions and fees charged by IB

plus execution quality compared to the daily volume weighted average price (*i.e.*, effective spread). For U.S. “Reg NMS” stocks, the ***total execution cost paid by IB clients over the past 12 months was only 6/10th of one basis point*** taking into account commissions and fees plus execution quality compared to VWAP.

At least one recent academic study also suggests that Interactive Brokers leads the U.S. brokerage industry in attempting to attain best execution for its clients’ orders. See Battalio, Robert H. and Corwin, Shane A. and Jennings, Robert H., ***Can Brokers Have It All? On the Relation between Make Take Fees & Limit Order Execution Quality*** (March 5, 2014). Available at SSRN: <http://ssrn.com/abstract=2367462> or <http://dx.doi.org/10.2139/ssrn.2367462>. Using public reports from the fourth quarter of 2012, business professors at the University of Notre Dame and the University of Indiana examined the order routing decisions of ten well-known U.S. brokerage firms including Interactive Brokers. They concluded as follows:

**“Examining routing decisions, we find that nine of the ten brokers route at least a portion of their orders to market makers that offer payment for marketable orders. \* \* \* The five brokers that do not delegate the handing of customer limit orders to market makers route their limit orders to one or more of the ‘traditional’ exchanges. *Of these, Interactive Brokers (IB) was the only broker to utilize more than one exchange. \* \* \* IB’s Rule 606 filing could provide an example of ‘optimized’ order routing.*”**

(emphasis added.)

#### Industry Awards and Recognition

IB has been ranked a top online broker by *Barron’s Magazine* for the last six years. In 2016, *Barron’s* also named IB ***“Best for International Traders”*** and the ***“Best for Frequent Traders.”*** *Barron’s* also rated IB the **lowest cost** online broker in 2015 and 2016.

Also in 2016, IB was named ***“Best Options Trading Platform - Broker”*** and ***“Best Broker-Dealer Futures”*** in the *Wall Street Letter* Institutional Awards.

In 2015, IB was named ***“Best Cross Asset Trading Solution”*** in the *Wall Street Letter* Institutional Awards. IB was named ***“Best Prime Broker – Startups”*** in the *Hedge Fund Manager Magazine* U.S. Hedge Fund Services Awards.

In 2014, IB was named the ***“Best Prime Broker – Technology”*** in the *Hedge Fund Manager Magazine* U.S. Hedge Fund Services Awards. IB was named the ***“Best Broker-Dealer Overall”*** in the *Wall Street Letter* Institutional Awards, and the ***“Best Stock Brokerage, Futures Brokerage, and Forex Brokerage”*** by *Stocks and Commodities* magazine.

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The combination of Interactive Brokers' extremely strong capital position, experienced and cautious management, strict regulatory oversight, best execution technology and low cost make IB an excellent choice as a prime broker and custodian for global financial advisors, funds and introducing brokers who want to provide a safe, secure and cost-effective global investment platform for their clients.

Please feel free to contact me with any questions or if you need additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "David M. Battan". The signature is fluid and cursive, with a long horizontal stroke extending from the end.

David M. Battan