

Hedge Fund Alert

THE WEEKLY UPDATE ON FUND MANAGEMENT INTELLIGENCE

Prime Broker That Actively Courts Small Hedge Funds Vaults Up Ranking of Busy Brokerages

Interactive Brokers, an afterthought to many in the hedge fund prime-brokerage business, gained a huge number of clients in the past year, mostly by catering to the smallest of managers.

The firm almost doubled the number of hedge funds it services, according to annual Form ADV filings submitted by managers to the SEC as of April 10. That was enough to place the brokerage fifth in **Hedge Fund Alert's** latest annual ranking of prime brokers, up from eighth last year and now behind only blue-chip industry heavyweights **Goldman Sachs, Morgan Stanley, J.P. Morgan and Bank of America**. And the ranking put Interactive Brokers ahead of industry stalwarts **UBS, BNP Paribas, Barclays and Citigroup**, though all of those institutions generate far more business and revenue from their hedge fund clients.

Interactive Brokers' fund tally, 793, is up by 384 over last year's placement. The increase is the largest by any prime broker in the ranking since 2015, when **Hedge Fund Alert** began tracking both registered and exempt-reporting investment managers' Form ADV filings. Until now, Goldman laid claim to the biggest annual increase when it added a net 201 funds in 2022.

Interactive Brokers, based in Greenwich, Conn., is a publicly traded firm that caters to both retail and professional clients and that specializes in low-cost, automated services to hedge funds and to other clients without imposing custody fees or minimum balances.

While the firm does have some large funds on its client roster, the vast bulk of its hedge fund business is with very small managers. On average, its client funds managed just \$123.5 million of gross assets, a fraction of the average fund size for fourth-ranked BofA (\$7.2 billion), or sixth-ranked UBS (\$6.6 billion).

Interactive Brokers' polar opposite on the rank-

ing, **Societe Generale**, had just 115 funds identified as prime-brokerage clients in the SEC data, but the average gross assets for those vehicles amounted to an astonishing \$17.7 billion apiece, the highest such figure in the top 25 and a likely reflection of SocGen's attention to fund-management giants.

Moreover, the median gross size of Interactive Brokers' funds is just \$13 million, compared to BofA's \$708 million and UBS' \$477 million.

The funds that Interactive Brokers added in the past year were even smaller. The vehicles had an average gross asset size of just \$27 million and a median size of \$5 million.

"At first [in 2009] when we got into the prime-brokerage business, nobody wanted to touch us," said **Steve Sanders**, Interactive Brokers' executive vice president of marketing and product development. "Our roots were in options market-making. People didn't really want to deal with us because when you talk to hedge fund clients, they want some big, well-known name, and we didn't have that in the prime-brokerage space."

While the largest prime brokers rely in part on their staffing and human servicing of clients and seek out the biggest and potentially most successful funds, Interactive Brokers instead has largely depended on its technology and pricing to draw customers. And, unlike many of its competitors, the firm unabashedly goes after the little operations.

"It doesn't cost us a lot of money to take on anybody because we are fully automated," Sanders said of the firm's offerings, which include more than 90 different kinds of order types on assets worldwide. "We're probably the low-cost provider. If someone is focusing on cost and product, we are the only game in town."

In a nod to bigger clients, the firm last year did begin providing a dedicated client-services representative – without charge – to each customer with at least \$100 million of assets with the brokerage.

Interactive Brokers doesn't provide traditional capital-introduction or consulting services, but the firm does offer a monthly online cap-intro seminar, which typically attracts more than 200 accredited investors

to hear pitches from a handful of Interactive Brokers' hedge fund clients. The company also has an outsourced trading desk.

Among the biggest funds that Interactive Brokers added in the past year, according to Form ADV filings: a **Ulysses Management** vehicle that had \$1.2 billion of gross assets and that reported J.P. Morgan, Morgan Stanley and **R.J. O'Brien Securities** as additional prime brokers; a \$1.1 billion **Landscape Capital** fund that also tapped UBS and **Wells Fargo** for prime-brokerage services; a \$681 million **RK Capital** offering whose SEC filing shows it switched from rival prime broker **Clear Street** to Interactive Brokers and **Marex**; and a \$611 million **Arrington Capital** fund for which Interactive Brokers was the only prime broker.

For the first time this year, Hedge Fund Alert expanded its annual listing to include the average gross and median gross assets at the prime brokers' hedge funds. The resulting data illustrates the degree to which many prime brokers' businesses are skewed toward large and/or highly leveraged hedge funds.

For example, while the ranking's top three prime brokers – Goldman Sachs, Morgan Stanley and J.P. Mor-

gan – have the most fund clients, with 2,025, 1,804 and 1,643, respectively, the average and median gross assets of their client funds are far lower than those of a number of other prime brokers that placed further down the list, namely UBS, BNP Paribas, Barclays, Citigroup, **HSBC** and Societe Generale.

The new ranking also includes the average number of prime brokers listed on each fund the brokers service.

Interactive Brokers is growing overall, beyond just its hedge fund clients. The operation had some 3.6 million accounts as of the first quarter this year, up 32% from a year ago. And the company's stock price, at \$203 a share on June 10, is almost triple its value at the beginning of 2023.

Hedge Fund Alert's prime broker ranking largely reflects annual filings with the SEC by both registered investment managers and exempt-reporting managers. The ranking is based on gross hedge fund assets as reported by those managers. The vast majority of the filings represent yearend data. Form ADV filings typically don't capture U.S.-based managers that run less than \$25 million of gross assets or non-U.S. managers that run less than \$25 million of gross assets attributed to U.S. investors. ■