

KGS-Alpha Capital Markets, L.P.
(SEC I.D. No. 8-68390)

FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULES
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2017
AND
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

This report is deemed CONFIDENTIAL in accordance
with Rule 17a-5(e)(3) under the Securities Exchange Act of 1934.
A Statement of Financial Condition, bound separately, has been filed with the
Securities and Exchange Commission.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

| | |
|---|-----------------|
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Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING 01/01/17 AND ENDING 12/31/17
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: KGS-Alpha Capital Markets, L.P.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

OFFICIAL USE ONLY

FIRM I.D. NO

521 5th Avenue, 3th Floor

(No. and Street)

New York,

New York

10175

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Robert P. Seery

(646) 588-2170

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT REGISTERED PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Deloitte & Touche LLP

(Name - if individual, state last, first, middle name)

30 Rockefeller Plaza

New York,

New York

10112-0015

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

☒ Certified Public Accountant

☐ Public Accountant

☐ Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

KGS-ALPHA CAPITAL MARKETS, L.P.

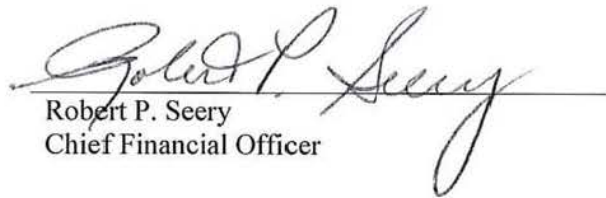
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| <input checked="" type="checkbox"/> (m) An Affirmation. | |
| <input checked="" type="checkbox"/> (n) A copy of the SIPC Supplemental Report (filed separately). | |
| <input checked="" type="checkbox"/> (o) A Report Describing the Broker-Dealers Compliance with the Exemption Provisions of Section k of SEC Rule 15c3-3 (the "Exemption Report") and Report of Independent Registered Public Accounting Firm Thereon (filed separately). | |

*** For conditions of confidential treatment of certain portions of this filing, see section 240.17a-15(e)(3).*

AFFIRMATION

I, Robert P. Seery, affirm that, to the best of my knowledge and belief, the accompanying financial statements and supplemental schedules pertaining to KGS-Alpha Capital Markets, L.P. (the "Company") as of and for the year ended December 31, 2017, are true and correct. I further affirm that neither the Company nor any partner, officer or director has any proprietary interest in any account classified solely as that of a customer.


Robert P. Seery
Chief Financial Officer

Subscribed and Sworn to before me this
23th day of February, 2018


Notary Public

ETIENNE BARG-TOWNSEND
NOTARY PUBLIC-STATE OF NEW YORK
No. 02BA6349437
Qualified In Queens County
My Commission Expires 10-17-2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Partners of
KGS-Alpha Capital Markets, L.P.
New York, New York

Opinion on the Financial Statements

We have audited the accompanying statement of financial condition of KGS-Alpha Capital Markets, L.P. (the "Company") as of December 31, 2017, and the related statements of income, cash flows, and changes in partners' equity, for the year then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud.

Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Report on Supplemental Schedules

The supplemental schedules f, g, h, and j listed in the accompanying table of contents have been subjected to audit procedures performed in conjunction with the audit of the Company's financial statements. The supplemental schedules are the responsibility of the Company's management. Our audit procedures included determining whether the supplemental schedules reconcile to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental schedules. In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, including their form and content, are presented in compliance with Rule 17a-5 under the Securities Exchange Act of 1934. In our opinion, such schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.

Deloitte + Touche LLP

February 23, 2018

We have served as the Company's auditor since 2010.

KGS-ALPHA CAPITAL MARKETS, L.P.**STATEMENT OF FINANCIAL CONDITION****AS OF DECEMBER 31, 2017****(Dollars in Thousands)****ASSETS:**

| | | |
|--|-----------|------------------|
| Cash | \$ | 6,591 |
| Securities segregated for regulatory purposes | | 2,508 |
| Securities purchased under agreements to resell (including \$4,441,895 at fair value) | | 4,469,675 |
| Financial instruments owned, at fair value (including \$4,126,517 pledged) | | 4,507,371 |
| Receivables from broker-dealers and clearing organizations | | 143,431 |
| Receivables from customers | | 11 |
| Accrued interest receivable | | 16,005 |
| Receivables from affiliates | | 9,418 |
| Furniture, equipment, software, and leasehold improvements, at cost, less accumulated depreciation and amortization of \$5,448 | | 1,522 |
| Other assets | | 3,197 |
| TOTAL ASSETS | \$ | 9,159,729 |

LIABILITIES AND PARTNERS' EQUITY:**LIABILITIES:**

| | | |
|--|----|------------------|
| Securities sold under agreements to repurchase (including \$4,135,771 at fair value) | \$ | 7,813,855 |
| Financial instruments sold, not yet purchased, at fair value | | 956,096 |
| Payables to broker-dealers and clearing organizations | | 67,491 |
| Payable to customers | | 1,364 |
| Accrued interest payable | | 4,158 |
| Accrued expenses and other liabilities | | 84,282 |
| TOTAL LIABILITIES | | 8,927,246 |

| | | |
|-------------------------|--|----------------|
| PARTNERS' EQUITY | | 232,483 |
|-------------------------|--|----------------|

| | | |
|---|-----------|------------------|
| TOTAL LIABILITIES AND PARTNERS' EQUITY | \$ | 9,159,729 |
|---|-----------|------------------|

See notes to financial statements.

KGS-ALPHA CAPITAL MARKETS, L.P.
STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2017
(Dollars in Thousands)

REVENUES:

| | | |
|------------------------|----|-----------------------|
| Principal transactions | \$ | 201,518 |
| Fee Income | | 4,757 |
| Interest | | 93,088 |
| Total Revenues | | <u>299,363</u> |
| Interest expense | | 129,516 |
| Net Revenues | | <u>169,847</u> |

EXPENSES:

| | | |
|-------------------------------------|-----------|----------------------|
| Employee compensation and benefits | | 91,681 |
| Professional fees | | 3,852 |
| Occupancy and equipment | | 3,458 |
| Technology and information services | | 10,678 |
| Marketing and business development | | 2,237 |
| Brokerage and clearance fees | | 4,204 |
| Other expenses | | 1,096 |
| Total Expenses | | <u>117,206</u> |
| NET INCOME | \$ | <u>52,641</u> |

See notes to financial statements.

KGS-ALPHA CAPITAL MARKETS, L.P.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2017 (Dollars in Thousands)

| | |
|---|-------------------|
| Cash Flows From Operating Activities: | |
| Net Income | \$ 52,641 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Non-cash item included in net income: | |
| Depreciation and amortization expense | 702 |
| Share-based incentive compensation | 1,716 |
| Write-off of fixed assets | 6 |
| Decreases (increases) in operating assets: | |
| Securities segregated for regulatory purposes | 2,946 |
| Securities purchased under agreements to resell | 191,035 |
| Financial instruments owned, at fair value | (246,033) |
| Receivables from broker-dealers and clearing organizations | 201,946 |
| Receivables from customers | 16,058 |
| Accrued interest receivable | (1,059) |
| Receivable from affiliate | 2,205 |
| Loans, at fair value | 2,030 |
| Other assets | 2,022 |
| (Decreases) increases in operating liabilities: | |
| Securities sold under agreements to repurchase | (164,524) |
| Financial instruments sold, not yet purchased, at fair value | 141,985 |
| Payable to broker-dealers and clearing organizations | (198,377) |
| Payables to customers | (1,584) |
| Accrued interest payable | 1,737 |
| Payable to affiliate | (202) |
| Accrued expenses and other liabilities | 27,211 |
| Net cash provided by operating activities | <u>32,461</u> |
| Cash Flows From Investing Activities: | |
| Purchase of furniture, equipment, software, and leasehold improvements | <u>(780)</u> |
| Net cash used in investing activities | <u>(780)</u> |
| Cash Flows From Financing Activities: | |
| Capital contributions received | 327 |
| Capital withdrawals | (30,223) |
| Redemptions | <u>(504)</u> |
| Net cash used in financing activities | <u>(30,400)</u> |
| Net increase in cash | 1,281 |
| Cash, January 1, 2017 | <u>5,310</u> |
| Cash, December 31, 2017 | <u>\$ 6,591</u> |
| Supplemental cash flow disclosure | |
| Cash paid during the year for interest | <u>\$ 127,779</u> |

See notes to financial statements.

KGS-ALPHA CAPITAL MARKETS, L.P.
STATEMENT OF CHANGES IN PARTNERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2017
(Dollars in Thousands)

| | General Partner | | Limited Partners | Total | |
|------------------------------------|------------------------|------------|-------------------------|----------------|-------------------|
| BALANCE, December 31, 2016 | \$ | 88 | \$ | 208,438 | \$ 208,526 |
| Net Income | | 53 | | 52,588 | 52,641 |
| Share-based incentive compensation | | - | | 1,716 | 1,716 |
| Contributions | | - | | 327 | 327 |
| Withdrawals | | - | | (30,223) | (30,223) |
| Redemptions | | - | | (504) | (504) |
| BALANCE, December 31, 2017 | <u>\$</u> | <u>141</u> | <u>\$</u> | <u>232,342</u> | <u>\$ 232,483</u> |

See notes to financial statements.

KGS-ALPHA CAPITAL MARKETS, L.P.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2017 (Dollars in Thousands)

1. ORGANIZATION AND BASIS OF PRESENTATION

Nature of Business — KGS-Alpha Capital Markets, L.P. (“Company”), a Delaware limited partnership, is a broker-dealer registered with the Securities and Exchange Commission (“SEC”) and is a member of the Financial Industry Regulatory Authority, Inc. (“FINRA”). The Company primarily markets and trades Agency and Non-Agency Mortgage-backed Securities and other fixed income Asset Backed credit products. The Company’s head office is in New York City and it has additional offices in New York State, California, Florida, Virginia, Arizona, New Jersey, and Illinois. The Company self-clears its financing transactions and a portion of its proprietary trading, while clearing the remainder of its proprietary trading and its customer transactions through Pershing LLC, (“Clearing Broker”) on a fully disclosed basis.

KGS-Alpha Capital Markets GP, LLC (“KGS-Alpha GP”), a Delaware limited liability company, and KGS Holdings, L.P. (“KGS Holdings”) are the sole general and limited partner (collectively the “Partners”), respectively, of the Company. KGS-Alpha GP is wholly owned by KGS Holdings.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates — The financial statements were prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents — The Company considers its investments in highly liquid financial instruments with maturities of less than 90 days when issued to be cash equivalents. As of December 31, 2017, the Company did not hold any cash equivalents.

Securities Segregated for Regulatory Purposes — The Company is subject to SEC Rule 15c3-3 and as such may be required to deposit cash and/or eligible securities to meet customer reserve computation requirements. As of December 31, 2017, the Company has on deposit \$2,508 of eligible securities in its Special Reserve Bank Account for the Exclusive Benefit of Customers.

Customer Transactions — Customer securities transactions are recorded on a trade date basis with related revenue included in Principal transactions in the Statement of Income.

Furniture, Equipment, Software and Leasehold Improvements — Fixed assets are stated at cost less accumulated depreciation and amortization. Depreciation on computer equipment and software is computed using the straight-line method over a period up to three years. Depreciation on furniture, fixtures and non-computer related equipment is computed using the straight-line method over a period of five years. Amortization on leasehold improvements is computed using the straight-line method over the life of the applicable lease.

The costs of internally developed software that qualify for capitalization are capitalized as fixed assets and subsequently amortized over the estimated useful life of the software, which is generally three years. The costs of internally developed software are included in fixed assets at the point at which the conceptual formulation, design and testing of possible software project alternatives are complete and management

authorizes and commits to funding the project. The Company does not capitalize pilot projects and projects where it believes that the future economic benefits are less than probable.

Income Taxes — The Company is a limited partnership, wholly owned by KGS Holdings, disregarded for federal, state and local income tax purposes. Accordingly, there is no provision for income taxes in the accompanying financial statements.

The Company recognizes tax positions in the financial statement only when it is more-likely-than-not, based on the technical merits, that the position will be sustained upon examination by the relevant taxing authority. Based upon the Company's review of its federal, state and local income tax returns and tax filing positions, the Company determined no unrecognized tax benefits for uncertain tax positions were required to be recorded. In addition, the Company does not believe that it has any tax positions for which it is reasonably possible that it will be required to record significant amounts of unrecognized tax benefits within the next twelve months. The Company's accounting policy provides that interest and penalties related to income taxes is to be included in other expense.

There is no tax sharing agreement between the Company and the General Partner, and there have been no distributions to the General Partner for reimbursements of taxes.

Financial instruments owned and Financial instruments sold, not yet purchased — Financial instruments owned and financial instruments sold, not yet purchased ("trading securities") are recorded at fair value and primarily consist of U.S Treasury securities, Agency and Non-Agency mortgage-backed. Gains and losses arising from all transactions in trading securities are recorded on a trade date basis and included in Principal transactions revenue on the Statement of Income. Trading securities are recorded at fair value as required by accounting pronouncements.

Derivatives — Derivatives are used to manage the Company's exposures to interest, credit, and other market risks associated with trading activities. The most frequently used derivative products are To Be Announced ("TBA") contracts, futures and options on futures and credit default swaps. All derivative instruments are recorded at fair value. The Company uses industry standard derivative contracts whenever appropriate.

The realized and unrealized gains and losses on derivatives are recognized in Principal transactions on the Statement of Income. TBAs and credit default swaps in a receivable position are reported in Financial instruments owned and TBAs and credit default swaps in a liability position are reported in Financial instruments sold, not yet purchased on the Statement of Financial Condition. Futures and options on futures in a receivable position are reported in Receivables from broker-dealers and clearing organizations and futures and options on futures in a payable position are reported in Payables to broker-dealers and clearing organizations on the Statement of Financial Condition.

Securities Purchased Under Agreement to Resell and Securities Sold Under Agreements to Repurchase — The Company purchases securities under agreements to resell ("reverse repurchase agreements") and takes possession of these securities. Reverse repurchase agreements are treated as collateralized lending transactions whereby the Company monitors the market value of the securities purchased and additional collateral is obtained when appropriate. The Company also has the right to liquidate the collateral held in the event of counterparty default. The Company also sells securities under agreements to repurchase ("repurchase agreements"), which are treated as collateralized borrowing transactions.

Certain reverse repurchase agreements and repurchase agreements are recorded on the Statement of Financial Condition at fair value while the remaining reverse repurchase agreements and repurchase agreements are recorded at their contracted resale or repurchase amount plus accrued interest. Interest earned on reverse repurchase agreements is included in interest income, and interest incurred on repurchase

agreements is included in Interest expense, respectively, on the Statement of Income. Reverse repurchase agreements and repurchase agreements are presented in the Statement of Financial Condition on a net-by-counterparty basis, where permitted by generally accepted accounting principles, as further described in note 14. Changes in fair value for reverse repurchase agreements and repurchase agreements are included in Principal transactions on the Statement of Income. Should the fair value of the underlying securities decline or increase, additional collateral is requested or excess collateral is returned, as appropriate.

Loans, at fair value — The Company had elected the fair value option for loans that consist of Small Business Association (“SBA”) loans. SBA loans consist of Confirmation of Originator Fees (“COOFs”). COOFs are issued by Colson Services Corporation on behalf of the United States Small Business Administration, and consist of an interest-only strip of certain underlying loans which were originated under Section 7(a) of the Small Business Act, as amended.

The Company sold its SBA loans in 2017.

Interest is recognized as revenue when earned and deemed collectible on the loans. Changes in fair value are recurring and are reported on the Statement of Income as a component of Principal Transactions.

Fair Value Measurements — Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions other market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities the Company has the ability to access.
- Level 2 inputs are inputs (other than quoted prices included within level 1) that are observable for the asset or liability, either directly or indirectly.
- Level 3 are unobservable inputs for the asset or liability and rely on management’s own assumptions about the assumptions that market participants would use in pricing the asset or liability.

Estimating fair value requires the application of judgment. The type and level of judgment required is largely dependent on the amount of observable market information available to the Company. For instruments valued using internally developed models that use significant unobservable inputs and are therefore classified within level 3 of the valuation hierarchy, judgments used to estimate fair value are more significant than those required when estimating the fair value of instruments classified within levels 1 and 2.

The Company’s business units are responsible for valuing their respective portfolio of financial instruments. The business unit’s supervisor reviews and approves the valuation, and the Company’s Chief Risk Officer (“CRO”) reviews the valuation and recommends changes if necessary. The Company’s Valuation Committee, who reports to the Board of Directors, when necessary, consists of the Chief Executive Officer (“CEO”), the CRO, and the Chief Financial Officer (“CFO”), and provides additional oversight on financial instruments fair value policies and practices, escalating significant valuation issues, and reviewing and

approving valuation adjustment methodologies. For financial instruments categorized within Level 3 of the fair value hierarchy, the Valuation Committee reviews the business unit's valuation techniques and inputs on a monthly basis to ensure these are consistent with market participant assumptions.

See note 4 for a description of valuation techniques applied to the major categories of financial instruments measured at fair value.

Interest Income and Interest Expense — The Company recognizes contractual interest on financial instruments owned and financial instruments sold, not yet purchased, on an accrual basis as a component of interest revenue and expense. This is included within Principal Transactions in the Statement of Income. In addition, the Company recognizes interest revenue related to its securities purchased under agreements to resell activities and interest expense related to its securities sold under agreements to repurchase activities on an accrual basis, which is included within Interest Income and Interest Expense in the Statement of Income. The Company recognizes interest on loans on an accrual basis as a component of interest revenue.

The Company has a variable funding promissory note with one of its affiliates, KGS-Alpha Financial Services, LLC ("Financial Services"). The Company recognizes interest on these promissory notes on an accrual basis as a component of interest revenue. See note 16.

Fair Value of Financial Instruments — The amounts presented for financial assets and liabilities on the Statement of Financial Condition are carried at fair value or at amounts that, because of their short-term nature, approximate current fair value.

Fee Income — Fee income is underwriting revenues representing gains, losses, and fees arising from securities offerings in which the Company acts as a co-manager or broker. Co-manager and broker fees are recorded when services are substantially completed and reasonably determinable and are recorded net of transaction related expenses.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*. The new guidance will create a more principles-based approach to revenue recognition. Under the new guidance, companies will recognize revenue to depict the transfer of goods or services to customers in amounts that reflect consideration to which a company expects to be entitled in exchange for those goods or services by applying a five step-process. The standard would require additional disclosures and provide more guidance for transactions such as revenue and contract modification. The guidance must be adopted using either a full retrospective approach or a modified retrospective approach. In addition, an explanation of the significant changes between the reported results under the new revenue standard and prior US GAAP is needed. The guidance will be applicable for the Company in the fiscal year beginning January 1, 2018. The Company will implement this new standard on the required effective date using the modified retrospective method and has determined that the standard will not have a material impact on the financial statements. Additional disclosures will be required for the financial statements ending December 31, 2018.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The update changes certain aspects of the recognition, measurement, presentation, and disclosure of financial instruments. In particular, this ASU requires that certain equity instruments be measured at fair value, with changes in fair value recognized in earnings; there will no longer be an available-for-sale classification (changes in fair value reported in other comprehensive income) for equity securities with readily determinable fair values. The new standard affects all entities that hold financial assets or owe financial liabilities and is effective for annual

reporting periods (including interim periods) beginning after December 15, 2017. Early adoption of the ASU is not permitted, except for the amendments relating to the presentation of the change in the instrument-specific credit risk relating to a liability that an entity has elected to measure at fair value. The Company will implement the standard on its effective date and does not expect it to have a material impact on its financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). Under the new ASU, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. The liability will be equal to the present value of lease payments. The asset, referred to as a “right-of-use asset” will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, leases will be classified as either operating or finance. Operating leases will result in straight-line expense (similar to current operating leases) while finance leases will result in a front-loaded expense pattern (similar to current capital leases). Classification will be based on criteria that are largely similar to those applied in current lease accounting, but without explicit bright lines. New quantitative and qualitative disclosures, including significant judgments made by management, will be required to provide greater information regarding the extent of revenue and expense recognized and expected to be recognized from existing contracts. This standard is effective for fiscal years beginning after December 15, 2018. The Company will implement the standard on its effective date. Upon adoption of this ASU, the Company expects to report increased assets and liabilities on its consolidated statement of financial condition as a result of recognizing right-of-use assets and lease liabilities related to certain equipment under noncancelable operating lease agreements, which currently are not reflected in its consolidated statement of financial condition. The adoption of this standard is not anticipated to have a material impact on the Company's net capital.

In June 2016 the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses* (Topic 326): *Measurement of Credit Losses on Financial Instruments*. The ASU replaces existing incurred loss impairment guidance and establishes a single allowance framework for financial assets carried at amortized cost (including securities classified as held-to-maturity), which will reflect management's estimate of credit losses over the full remaining expected life of the financial assets. The ASU also amends existing impairment guidance for securities classified as available-for-sale to incorporate an allowance, which will allow for reversals of impairment losses in the event that the credit of an issuer improves. The ASU requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. The ASU is effective for annual periods beginning after December 15, 2019. The Company will implement the standard on its effective date and does not expect it to have a material impact on its financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows* (Topic 230). The ASU intended to reduce diversity in practice how certain transactions are classified in the Statement of cash flows by mandating classification of certain activities. The ASU is effective for annual periods beginning after December 15, 2018. Early adoption is permitted. The Company will implement the standard on its effective date and does not expect it to have a material impact on its financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows* (Topic 230): *Restricted Cash*, which is intended to reduce diversity in the presentation of restricted cash and restricted cash equivalent in the statements. The statement requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. This ASU is effective for annual reporting periods beginning after December 15, 2017, and interim periods within those fiscal years. The Company will implement the standard on its effective date. The new standard will change the presentation of the statement of cash flows but the Company does not expect it to have a material impact on the Company's financial statements.

4. FAIR VALUE MEASUREMENTS

The Company's trading instruments are evaluated with the fair value hierarchy, based on the nature of inputs used to determine the fair value at the measurement date. See note 2 for a discussion of the Company's policies regarding this hierarchy.

A description of the valuation techniques applied to the Company's major categories of trading instruments are as follows:

Securities Purchased/Sold under Agreements to Resell/Repurchase

The fair value of reverse repurchase and repurchase agreements are determined using discounted cash flow models using multiple market inputs, including interest rates and spreads. The inputs are generally from actively quoted markets and can be validated through external sources, including brokers, pricing services, and market transactions. Reverse repurchase and repurchase agreements are generally categorized in Level 2 of the fair value hierarchy.

U.S. Government Securities

U.S. government securities are valued using quoted market prices. Valuation adjustments are not applied. U.S. government securities are categorized in Level 1 of the fair value hierarchy.

U.S. Agency Securities

U.S. agency securities primarily consist of mortgage pass-through securities and mortgage pass-through certificates. The fair value of mortgage pass-through certificates are model driven with respect to the comparable TBA security. Mortgage pass-through certificates are generally categorized in Level 2 of the fair value hierarchy.

Non-Agency Securities

Non-agency securities consist of mortgage pass-through certificates and are generally valued based on external price/spread data or, in certain cases, on prices of comparable bonds. Non-agency mortgage pass-through certificates are generally categorized in Level 2 of the fair value hierarchy.

Options on Futures and Futures

Options on futures ("options") and futures are valued using quoted market prices. Valuation adjustments are not applied. Options are categorized in Level 2 and futures are categorized in Level 1 of the fair value hierarchy.

Derivative Contracts

Credit default swaps contracts are generally valued using a model, whose inputs reflect assumptions that we believe market participants would use in valuing the derivative in a current period transaction. Inputs to valuation models are appropriately calibrated to market data. For many derivative contracts, the valuation models do not involve material subjectivity as the methodologies do not entail significant judgment and the inputs to valuation models do not involve a high degree of subjectivity as the valuation model inputs are readily observable or can be derived from actively quoted markets. TBA securities are generally valued using quoted market prices or are benchmarked thereto. Derivative contracts are categorized in Level 2 of the fair value hierarchy.

Fair Value Option

The Company has elected the fair value option for certain instruments to more accurately reflect market and economic events in its earnings and to mitigate a potential imbalance in earnings caused by using different measurement attributes (i.e. fair value versus carrying value) for certain assets and liabilities. The fair value option election allows entities to irrevocably elect fair value as the initial and subsequent measurement

attribute for certain financial assets and liabilities. Changes in fair value are recognized in earnings as they occur for those assets and liabilities for which the election is made. The election is made on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. For those financial assets and liabilities not carried at fair value, the carrying value approximates fair value due to their short term nature, and they are considered Level 2 in the fair value hierarchy.

The Company has elected the fair value option for repurchase agreements and reverse repurchase agreements that have an open settlement date or that are not accounted for as purchase and sale agreements. The aggregate carrying amount of reverse repurchase agreements and repurchase agreements for which fair value option was elected are \$4,442,036 and \$4,135,758, respectively.

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of December 31, 2017:

| | Fair Value Measurements on a Recurring Basis | | |
|--|--|--------------|--------------|
| | Level 1 | Level 2 | Total |
| Assets | | | |
| Securities segregated for regulatory purposes: | | | |
| US agency securities | \$ - | \$ 2,508 | \$ 2,508 |
| Securities purchased under agreements to resell: | | | |
| US agency securities | - | 4,095,276 | 4,095,276 |
| US government | - | 346,619 | 346,619 |
| Total Securities purchased under agreements to resell | - | 4,441,895 | 4,441,895 |
| Financial instruments owned: | | | |
| US government and agency securities | 3,155 | 4,466,463 | 4,469,618 |
| TBAs | - | 2,537 | 2,537 |
| Non-agency | - | 21,148 | 21,148 |
| Options | - | 13,784 | 13,784 |
| Credit default swap contracts | - | 284 | 284 |
| Total Financial instruments owned | 3,155 | 4,504,216 | 4,507,371 |
| Receivable from broker-dealers and clearing organizations: | | | |
| Futures | 1,734 | - | 1,734 |
| Total | \$ 4,889 | \$ 8,948,619 | \$ 8,953,508 |
| Liabilities | | | |
| Securities sold under agreements to repurchase: | | | |
| US agency securities | \$ - | \$ 3,836,181 | \$ 3,836,181 |
| US government | - | 299,590 | 299,590 |
| Total Securities sold under agreements to repurchase | - | 4,135,771 | 4,135,771 |
| Financial instruments sold, not yet purchased: | | | |
| US government and agency securities | 934,384 | 193 | 934,577 |
| TBAs | - | 9,139 | 9,139 |
| Credit default swap contracts | - | 12,380 | 12,380 |
| Total Financial instruments sold | 934,384 | 21,712 | 956,096 |
| Total | \$ 934,384 | \$ 4,157,483 | \$ 5,091,867 |

During the twelve months ended December 31, 2017, there were no transfers of assets or liabilities between fair value measurement classifications.

5. DERIVATIVES

Derivatives are subject to various risks similar to other financial instruments, including market, credit and operational risk. The risks of derivatives should not be viewed in isolation, but rather should be considered on an aggregate basis along with the Company's other trading-related activities. The Company manages the risks associated with derivatives on an aggregate basis along with the risks associated with proprietary trading as part of its risk management policies.

The following table presents the fair value and related number of derivative contracts at December 31, 2017 categorized by predominant risk exposure. The fair value of assets/liabilities related to derivative contracts represents the Company's gross receivable/payable for derivative financial instruments:

| | Assets | | Liabilities | |
|-------------------------------|------------------|---------------------|------------------|---------------------|
| | Fair Value | Number of Contracts | Fair Value | Number of Contracts |
| Futures contracts | \$ 1,734 | 9,360 | \$ - | |
| Credit default swap contracts | 284 | 5 | 12,380 | 7 |
| TBAs | 2,537 | 81 | 9,139 | 36 |
| Options | 13,784 | 4 | - | |
| Total | <u>\$ 18,339</u> | | <u>\$ 21,519</u> | |

The number of contracts outstanding at December 31, 2017 is representative of the volume of derivative contracts outstanding at the end of each trading day during the year ended December 31, 2017.

The following table presents unrealized and realized gains and losses on derivative contracts for the twelve months ended December 31, 2017 and is included in Principal transactions in the Statement of Income:

Gains/(Losses):

| | |
|-------------------------------|--------------------|
| Futures contracts | \$ 670 |
| Credit default swap contracts | (2,334) |
| TBAs | (2,948) |
| Options | (40,529) |
| Total | <u>\$ (45,141)</u> |

6. FURNITURE, EQUIPMENT, SOFTWARE DEVELOPMENT, AND LEASEHOLD IMPROVEMENTS, NET

At December 31, 2017, furniture, equipment, software development and leasehold improvements, net consists of the following:

| | Cost | Accumulated Depreciation/ Amortization | Furniture, Equipment, and Leasehold Improvements, Net |
|--------------------------------|-----------------|--|---|
| Computer Equipment | \$ 2,975 | \$ (2,664) | \$ 311 |
| Furniture and Office Equipment | 820 | (191) | 629 |
| Software Development | 2,650 | (2,512) | 138 |
| Leasehold Improvements | 525 | (81) | 444 |
| | <u>\$ 6,970</u> | <u>\$ (5,448)</u> | <u>\$ 1,522</u> |

Depreciation and amortization for the twelve months ended December 31, 2017 was \$702 and is included in Occupancy and equipment expense on the Statement of Income.

In addition, the company incurred a write-off of Leasehold Improvements of \$4 and Software development and licensing of \$2 related to the retirement of assets no longer in use.

7. RECEIVABLES FROM BROKER-DEALERS AND CLEARING ORGANIZATIONS AND PAYABLES TO BROKER-DEALERS AND CLEARING ORGANIZATIONS

The following is a summary of receivable from, and payable to, brokers and dealers as of December 31, 2017:

| | <u>Receivable</u> | <u>Payable</u> |
|------------------------------------|-------------------|------------------|
| Fail to deliver/receive | \$ 3,959 | \$ - |
| Deposits at clearing organizations | 108,617 | - |
| Clearing Organizations | 25,038 | 54,171 |
| Pending trades (net) | 5,817 | - |
| Other | - | 13,320 |
| | <u>\$ 143,431</u> | <u>\$ 67,491</u> |

Financial instruments owned or sold are held by the Company's Clearing Broker as collateral for amounts payable to such Clearing Broker. The Company maintains a financing line with its Clearing Broker to finance the Company's trading activity. Amounts payable under the financing line bear interest at market rates, ranging from the Clearing Broker's cost of funds plus 0.33% to 0.50% per annum, depending on the type of collateral provided by the Company. Interest expense paid to the Clearing Broker amounted to \$869 for the twelve months ended December 31, 2017 and is included within Interest expense on the Statement of Income.

As of December 31, 2017, the guaranteed amount the Company was able to borrow under its financing line was \$1,000,000, as long as the Company maintains a minimum net liquidating value which is defined as a 7% equity requirement on all assets held at the Clearing Broker. As of December 31, 2017, the Company borrowed \$54,171 and this amount is recorded in Payables to broker-dealers and clearing organizations in

the Statement of Financial Condition. The average borrowings for the first twelve months in 2017 were \$60,805.

8. COLLATERALIZED TRANSACTIONS

The Company pledges financial instruments as collateral under repurchase agreements and in conjunction with clearing arrangements. The agreements with counterparties generally contain contractual provisions allowing the counterparty the right to sell or repledge the collateral. Trading securities that can be sold or repledged by the counterparty are included within Financial instruments owned and noted as pledged on the Statement of Financial Condition. At December 31, 2017, the approximate fair value of securities pledged as collateral by the Company was \$4,126,517.

The Company receives securities as collateral under reverse repurchase agreements. In many instances, the Company is permitted by contract or custom to re-hypothecate the securities received as collateral. These securities may be used to secure repurchase agreements or cover short positions. At December 31, 2017, the approximate fair value of securities received as collateral that can be sold or repledged by the Company was \$5,661,138.

At December 31, 2017, \$5,605,082 of the securities received had been sold or repledged.

The following table presents a disaggregation of the gross obligation by the class of collateral pledged and the remaining contractual maturity of the Repurchase agreements as of December 31, 2017:

| | Remaining Contractual Maturity | | | | Total |
|---|--------------------------------|----------------------|---------------------|-----------------|----------------------|
| | Overnight and Open | Less than 30 Days | 30-90 Days | Over 90 Days | |
| Securities sold under agreements to repurchase: | | | | | |
| US government and agency securities | \$ 320,450 | \$ 9,980,063 | \$ 1,630,533 | \$ - | \$ 11,931,046 |
| Non-agency securities | \$ - | \$ 17,572 | \$ - | \$ - | \$ 17,572 |
| Total | \$ 320,450 | \$ 9,997,635 | \$ 1,630,533 | \$ - | \$ 11,948,618 |

9. PARTNERS' CAPITAL

In 2017, the Company received capital contributions of \$327 from KGS Holdings by directors for services provided to the Company.

In 2017, KGS Holdings withdrew \$30,223, with \$3,000 being a return of capital and \$27,223 for tax distributions.

As of December 31, 2017, the Company had payables to certain directors for services provided to the Company, which may be forgiven for equity contributions to KGS Holdings in 2017. As of December 31, 2017 the Company had a payable in the amount of \$425 which is included in Accrued expenses and other liabilities on the Statement of Financial Condition.

10. COMMITMENTS AND CONTINGENCIES

Operating Leases — The Company leases office space in each of its locations pursuant to operating lease agreements. These leases are generally subject to scheduled base rent and maintenance cost increases, which are recognized on a straight-line basis over the period of the leases.

The Company recorded rent expense for the twelve months ended December 31, 2017 of which \$2,158 is included in Occupancy and equipment expense on the Statement of Income.

At December 31, 2017, minimum future rental commitments under operating leases were as follows:

| | <u>Amount</u> |
|------------------------------|-----------------|
| 2018 | \$ 1,715 |
| 2019 | 1,560 |
| 2020 | 1,558 |
| 2021 | 1,531 |
| 2022 and thereafter | 615 |
| Total minimum lease payments | <u>\$ 6,979</u> |

Commitment — Pursuant to a management agreement between certain related parties, KGS Holdings and the Company (the “Management Agreement”), such related parties have agreed to provide specified financial and management consulting services to the Company. The Company has agreed to pay \$125 per quarter for such services commencing on August 5, 2010, provided that the Company’s annual net profits before taxes for the most recent fiscal year are \$5,000 or more. Management consulting expense for the twelve months ended December 31, 2017 allocated to the Company was \$500 and is included in Professional fees on the Statement of Income.

Mortgage-Related Commitments — The Company enters into forward contracts to purchase mortgage-backed securities as part of its trading activities. The fair value and notional amount of long mortgage-related commitments recorded on the Statement of Financial Condition was (\$540) and \$337,860, respectively, and the fair value and notional amount of short mortgage-related commitments was (\$2,103) and \$3,102, respectively, all with expected maturities of less than one year.

Forward Starting Repurchase Agreements — The Company enters into commitments to buy securities with agreements to resell and commitments to sell securities with agreements to repurchase securities on a forward starting basis that are primarily secured by U.S. government and agency securities. The notional amount of the forward starting repurchase agreements was \$6,350,000 at December 31, 2017 all with expected maturities of less than one year.

Legal — In the normal course of business, the Company could potentially be party to legal actions, including arbitrations, arising in connection with the Company’s activities. Where available information indicates that it is probable a liability had been incurred at the date of the financial statements and the Company can reasonably estimate the amount of that loss, the Company accrues the estimated loss by a charge to income. Management believes that the resolution of any known matters will not result in any material adverse effect on the Company’s financial position.

11. MANAGEMENT INCENTIVE UNITS

In connection with the formation of KGS Holdings, certain directors agreed to restrictions on a certain number of previously held ownership interests. These restricted ownership interests were structured as management incentive units (“MIUs”). MIUs represent eligible Class A Common units in KGS Holdings and may (subject to certain performance and service vesting criteria) provide certain directors with a right to

an increased proportion of profits in KGS Holdings. KGS Holdings accounts for the MIUs in accordance with the accounting guidance for equity-based awards. These costs are charged to the Company by KGS Holdings.

The partnership agreement of KGS Holdings defines the vesting conditions applicable to the MIUs. Generally, 51.0193% of the MIUs are subject to a service condition and 48.9807% are subject to both a market condition and a performance condition. In addition, the number of MIUs that can ultimately vest is limited to 34.3007% of the fully diluted KGS Holdings Class A Common units and was equal to 87,840 units at December 31, 2017.

For the 51.0193% of MIUs subject to the service condition, KGS Holdings has categorized these awards into two groups of vesting: (1) a 12 month cliff vesting award and (2) 48 separate monthly graded vesting awards, which represent 20% and 80% of the portion of MIUs subject to the service condition, respectively. The Company is allocated share-based compensation expense for these awards based on their grant date fair value over the requisite service period. For the twelve months ended December 31, 2017, the Company recognized (\$42) of share-based compensation expense related to these MIUs.

The remaining 48.9807% of the MIUs are subject to both a performance condition and a market condition which are based on the actual return of KGS Holdings Class A Common units in a future capital transaction, as defined, compared to a target return. The occurrence of such future capital transaction is considered to be a performance condition while the value of such Class A Common units at the time of said transaction is considered to be a market condition. As of December 31, 2017, the Company has not recorded any compensation expense associated with the MIUs subject to this performance condition as achievement.

One of the directors is considered a nonemployee and the related MIUs are remeasured each reporting period until the performance commitment is met. For the twelve months ended December 31, 2017, the Company recognized an increase in expenses of \$536 relating to the change in value of the nonemployee awards in Employee compensation and benefits in the Statement of Income.

From 2011 to 2015, certain employees have been granted Class B Units in EPL with corresponding unvested non-voting Class A Common MIUs in KGS Holdings LP. These Class B units vest in accordance with the same terms outlined in the KGS Holdings partnership agreement and are subject to repurchase provisions, upon certain termination events, at book value on the date of termination. These awards are accounted for as liability awards and are remeasured at each reporting date until the date of settlement. For the twelve months ended December 31, 2017, there was no expense recognized relating to these awards, as the value of these awards was zero. Share based compensation expense related to Class B units may be recognized in future periods if the value of these units increases.

The fair value of the MIUs was estimated by KGS Holdings using a Monte Carlo approach in a risk-neutral framework based on expected volatility, risk-free rates and correlation matrix. Expected volatility is calculated based on companies in the same peer group as the Company.

Activity in the MIUs is as follows:

| | Number of Units Eligible to Vest | Weighted Average Fair Value ¹ | Weighted Average Fair Value ² | Weighted Average Remaining Time to Achieve Service Vesting ¹ (in years) |
|---------------------------------------|--|--|--|---|
| Outstanding December 31, 2016 | 88,400 | \$ 120.65 | \$ 84.90 | 0.1 |
| Eligible Units Forfeited ³ | (560) | \$ 97.59 | \$ 66.32 | |
| Outstanding December 31, 2017 | <u>87,840</u> | \$ 120.80 | \$ 85.02 | 0.0 |

¹Assumes performance vesting target attained

²Assumes performance vesting target not attained

³Number of units that are forfeited based on Employee Incentive Compensation ("EIC") unit redemptions

12. EMPLOYEE INCENTIVE COMPENSATION

On February 24, 2014 the EPL Equity Incentive Plan (the "Plan") was newly implemented and approved by the Board of Directors (the "Board"). Under the plan, certain employees (the "Employees") are eligible for mandatory grants of Class C and Class D Preferred units (collectively, the "EPL Units") and cash bonuses by the Company (collectively, the "Award").

Class C Preferred units ("Class C units") represent an indirect interest in non-voting Class A Preferred units in KGS Holdings. Class D Common units ("Class D units") represent an indirect interest in a non-voting Class B Common unit in KGS Holdings.

Mandatory EPL Units are subject to three-year cliff vesting from the date of grant.

Prior to an Initial Public Offering, upon a termination of employment for any reason, EPL may repurchase any of the terminated employee's vested mandatory EPL Units at a purchase price equal to the then-current fair market value, which shall reflect the fair market value as of the most recent December 31, unless otherwise determined by the Board. The Company intends that the purchase price will reflect the fair market value of the Company at the time of exercise, as determined in good faith by the Board. The Company has no current intention to exercise this repurchase right.

Each employee holding vested mandatory EPL Units has a put right, exercisable during a certain period each year, to sell all or part of his/her vested mandatory EPL Units for 90% of tangible implied book value of the EPL Units. There were 109 units exercised for the twelve months ended December 31, 2017.

In 2017, certain employees were eligible to participate in an Additional Liquidity Right, whereby eligible employees were able to sell all or part of their eligible and vested 2014 EPL units at a value derived pursuant to a formula determined by the board. There were 963 units exercised for the twelve months ended December 31, 2017.

Compensation cost is measured based on the fair value of the total EPL unit value. The cash settlement feature is recognized and measured as a liability award and remeasured each period. The difference between the cash settlement and the total EPL unit value is classified and measured as an equity award.

For the twelve months ended December 31, 2017, the Company recognized \$9,393 of shared-based compensation expense related to the mandatory EPL Units. In addition, as of December 31, 2017, total unrecognized share-based compensation expense related to the mandatory EPL Units that have not yet vested was \$10,615 and this amount is expected to be recognized over a weighted average period of 2.52 years.

Activity in the Plan is as follows:

| | Number of Units Eligible to Vest - Class C | Weighted Average Fair Value - Class C | Number of Units Eligible to Vest - Class D | Weighted Average Fair Value - Class D | Weighted Average Remaining Time to Achieve Vesting (in years) |
|-------------------------------|--|---|--|---|--|
| Outstanding December 31, 2016 | 5,720 | \$ 921.25 | 5,720 | \$ 411.28 | 1.3 |
| Units Granted | 4,481 | \$ 1,000.00 | - | \$ - | - |
| Units Redeemed | (1,072) | \$ 1,000.00 | (1,072) | \$ 496.00 | - |
| Outstanding December 31, 2017 | <u>9,129</u> | <u>\$ 974.68</u> | <u>4,648</u> | <u>\$ 391.75</u> | 1.0 |

13. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

Market Risk and Credit Risk — In the normal course of business, the Company enters into transactions involving derivatives and other off-balance sheet financial instruments. The financial instruments may include exchange traded financial futures contracts, mortgage-backed TBA securities, derivative contracts and financial instruments sold, not yet purchased. These financial instruments are used to manage market risks and are, therefore, subject to varying degrees of market and credit risk. The Company enters into derivative transactions primarily to economically hedge other positions or transactions.

Futures contracts and TBAs provide for the delayed delivery of an underlying instrument. The contractual or notional amounts related to these financial instruments reflect the volume and activity and do not reflect the amounts at risk. Futures contracts are executed on an exchange and cash settlement is made on a daily basis for market movements. Accordingly, futures contracts generally do not have credit risk. TBAs are used by the Company in order to reduce exposure on financial instruments owned and are net settled on a periodic basis. The credit risk for TBAs is limited to the unrealized gains recorded within Financial instruments owned in the Statement of Financial Condition. Market risk is substantially dependent upon the value of the underlying financial instruments and is affected by market forces such as changes in interest rates.

The Company has sold financial instruments that it does not currently own and therefore will be obligated to purchase such financial instruments at a future date. The Company enters into such transactions in order to reduce interest rate exposure on bonds included in Financial instruments owned. The Company has recorded these obligations in the financial statements at December 31, 2017, at fair values of the related financial instruments and will incur a loss if the fair value of the financial instruments increases subsequent to December 31, 2017.

In connection with the Company's financing and securities settlement activities, the Company may pledge securities as collateral to support its financing sources including repurchase agreements. In the event counterparties are unable to meet their contractual obligations to return securities pledged as collateral, the Company may be exposed to the risk of acquiring the securities at prevailing market prices. The Company seeks to control this risk by monitoring the market value of securities pledged and by requiring adjustments of collateral levels in the event of excess exposure. Moreover, the Company established credit limits for such activities and monitors credit compliance.

The Company recognizes market risk as the potential change in the value of financial instruments caused by changes in interest rates or market values of the financial instruments underlying the instruments. The Company monitors its exposure to market risk through a variety of control procedures, including daily review of trade positions.

Concentration Risk — The Company is subject to concentration risk by holding large positions in certain types of financial instruments or commitments to purchase financial instruments of a single issuer, including U.S. Government and agency securities. The Company's trading securities include U.S. Government and agency securities, which, in the aggregate, represented approximately 48.8% of the Company's total assets at December 31, 2017.

14. OFFSETTING

The Company enters into securities purchased under agreements to resell and securities sold under agreements to repurchase transactions to, among other things, acquire securities to cover short positions and settle other securities obligations, to finance the Company's inventory positions. Except as described below, repurchase and reverse repurchase agreements, principally involving government and agency securities, are carried at amounts at which the securities subsequently will be resold or reacquired as specified in the respective agreements and include accrued interest. The Company has elected to net reverse repurchase and repurchase agreements that qualify for netting according to Accounting Standards Codification ("ASC") 210-20-45-11, *Offsetting of Amounts Related to Certain Purchase and Resale Agreements*.

The following tables present the gross amounts and the offsetting amounts of reverse repurchase agreements, repurchase agreements and derivatives as of December 31, 2017:

| | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Assets Presented on Balance Sheet | <u>Gross Amounts Not Offset on the Statement of Financial Condition</u> | | |
|-------------------------------|--|---|--|---|-----------------------------|------------------|
| | | | | Financial Instruments | Cash Collateral Received | Net Amount |
| Reverse repurchase agreements | \$ 8,606,946 | \$ 4,134,763 | \$ 4,472,183 ¹ | \$ 4,455,413 | \$ - | \$ 16,770 |
| Derivatives | 18,339 | - | 18,339 | 18,339 | - | - |
| Total | <u>\$ 8,625,285</u> | <u>\$ 4,134,763</u> | <u>\$ 4,490,522</u> | <u>\$ 4,473,752</u> | <u>\$ -</u> | <u>\$ 16,770</u> |

| | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Liabilities Presented on Balance Sheet | <u>Gross Amounts Not Offset on the Statement of Financial Condition</u> | | |
|-----------------------|---|---|--|---|-----------------------------|------------------|
| | | | | Financial Instruments | Cash Collateral Received | Net Amount |
| Repurchase agreements | \$ 11,948,618 | \$ 4,134,763 | \$ 7,813,855 | \$ 7,803,118 | \$ - | \$ 10,737 |
| Derivatives | 21,519 | - | 21,519 | 21,519 | - | - |
| Total | <u>\$ 11,970,137</u> | <u>\$ 4,134,763</u> | <u>\$ 7,835,374</u> | <u>\$ 7,824,637</u> | <u>\$ -</u> | <u>\$ 10,737</u> |

¹Includes Securities segregated for regulatory purposes of \$2,508

15. NET CAPITAL REQUIREMENTS

As a registered broker-dealer, the Company is subject to Uniform Net Capital Rule 15c3-1 of the SEC, which requires that the Company maintain minimum net capital, as defined, of \$250 or 2% of aggregate debit items, whichever is greater. The Company maintains \$678 in addition to \$250 net capital requirement under 15c3-1(a)(9) for certain additional capital requirements for broker dealers engaging in reverse repurchase agreements. As of December 31, 2017 the Company had net capital of \$78,292 which was \$77,364 in excess of its required minimum net capital of \$928.

The Company maintains proprietary accounts with its Clearing Broker ("PAB assets"). PAB assets are considered allowable assets in the computation of net capital pursuant to an agreement between the Company and the Clearing Broker which requires, among other things, that the Clearing Broker perform a computation of PAB assets similar to the customer reserve computation set forth in SEC Rule 15c3-3.

16. RELATED PARTY TRANSACTIONS

The Company enters into related party transactions with its affiliates in the normal course of business in connection with its SBA loan and other trading activities, financing, and general operations.

Management consulting expense allocated to the company for the twelve months ended December 31, 2017 was \$500, of which \$125 is unpaid as of December 31, 2017 and is included in Accrued expenses and other liabilities. See note 10.

The Company also had expenses to certain directors for services provided to the Company of \$425 for the twelve months ended December 31, 2017, of which \$425 is unpaid as of December 31, 2017 and is included in Accrued expenses and other liabilities. See note 9.

At December 31, 2017, amounts receivable and payable to the Company's affiliates are set forth in the table below:

Assets:

| | | |
|-----------------------------|----|-------|
| Receivables from affiliates | \$ | 9,418 |
|-----------------------------|----|-------|

Liabilities:

| | | |
|--|----|-----|
| Accrued expenses and other liabilities | \$ | 550 |
|--|----|-----|

In 2017, the Company had a variable funding note receivable with Financial Services in the amount of \$5,379, included in Receivables from affiliates. The loan receivable from Financial Services bears an interest rate of one month Libor plus 8% per annum calculated daily. The total interest income on the loan for the twelve months ended December 31, 2017 was \$552 and is included in Interest revenue on the Statement of Income.

The Company also has a \$2,100 loan receivable with KGS Holdings. The loan bears an interest rate of 2.5% per annum and is calculated daily. Total interest income on the loan for the twelve months ended December 31, 2017 was \$53 and is included in Interest revenue on the Statement of Income.

The Company pays for operating expenses on behalf of KGS Holdings, Financial Services, and KGS-Alpha RE Trading, LLC ("RE Trading"). The outstanding balance is included in Receivables from affiliates.

Amounts included in the Statement of Income relating to transactions with affiliates for the year ended December 31, 2017 is as follows:

Revenues:

| | | |
|----------|----|-----|
| Interest | \$ | 605 |
|----------|----|-----|

Expenses:

| | | |
|---|----|-----|
| Employee compensation and benefits (See note 9) | \$ | 425 |
| Professional fees (See note 10) | | 500 |

In addition to the above, the Company received capital contributions of \$327 from the Partners and had capital withdrawals of \$30,223 by the Partners (See note 9).

17. SUBSEQUENT EVENTS

The Company has performed its evaluation of subsequent events through the issuance date of the financial statements. Based upon such evaluation, no events were discovered that required disclosure or adjustment to the financial statements.

* * * * *

KGS-ALPHA CAPITAL MARKETS, L.P.

COMPUTATION OF NET CAPITAL FOR BROKERS AND DEALERS PURSUANT TO RULE 15C3-1 UNDER THE SECURITIES EXCHANGE ACT OF 1934 AS OF DECEMBER 31, 2017 (Dollars in Thousands)

| | |
|---|------------------|
| Partners' Capital | \$ 232,483 |
| TOTAL REGULATORY CAPITAL | <u>232,483</u> |
| NONALLOWABLE ASSETS | |
| Receivables from broker-dealers and clearing organizations | 46 |
| Financial instruments owned, non-marketable | 2,745 |
| Receivable from affiliates | 9,418 |
| Furniture, equipment, software, and leasehold improvements, at cost, less accumulated depreciation and amortization | 1,522 |
| Other assets | 2,197 |
| Total nonallowable assets | <u>15,928</u> |
| DEDUCTIONS/CHARGES | <u>9,484</u> |
| NET CAPITAL BEFORE HAIRCUTS ON SECURITIES POSITIONS | <u>207,071</u> |
| HAIRCUTS ON SECURITIES POSITIONS | |
| U.S. gov't obligations | 106,264 |
| Non-agency securities (corporate obligations) | 1,943 |
| Options | 13,784 |
| Credit Default swap contracts | 6,788 |
| Total Haircuts | <u>128,779</u> |
| NET CAPITAL | <u>\$ 78,292</u> |
| Minimum Net Capital Requirement | 250 |
| 15c3-1(a)(9) Additional Requirement | 678 |
| NET CAPITAL REQUIREMENT- Alternative method (2% of aggregate debit items, as defined, or \$250, whichever is greater) | <u>\$ 928</u> |
| NET CAPITAL IN EXCESS OF MINIMUM REQUIREMENT | <u>\$ 77,364</u> |
| TOTAL AGGREGATE DEBIT ITEMS | <u>\$ -</u> |
| RATIO OF AGGREGATE DEBIT ITEMS TO NET CAPITAL | <u>0%</u> |

No material differences exist between the above computation and the computation included in KGS-Alpha Capital Markets, L.P.'s corresponding Form X-17A-5 Part IIA filed on January 24, 2018.

KGS-ALPHA CAPITAL MARKETS, L.P.

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKERS AND DEALERS PURSUANT TO RULE 15c3-3 UNDER THE SECURITIES EXCHANGE ACT OF 1934 AS OF DECEMBER 31, 2017 (Dollars in Thousands)

CREDIT BALANCES

| | | |
|---|----|-------------|
| Free credit balances and other credit balances in customers' security accounts | \$ | 1,364 |
| Monies borrowed collateralized by customer securities | | - |
| Monies payable against customers' securities loaned | | - |
| Customer securities failed to receive | | - |
| Credit balances in firm accounts which are attributable to principal sales to customers | | - |
| Market value of stock dividends, stock splits, and similar distributions receivable | | - |
| Market value of short securities and credits outstanding over 30 calendar days | | - |
| Market value of securities in transfer over 40 days and not confirmed | | - |
| | | <hr/> |
| Total Credit Items | | <hr/> 1,364 |

DEBIT BALANCES

| | | |
|---|--|---------|
| Debit balances in customers' security accounts | | - |
| Securities borrowed to effectuate short sales by customers' securities borrowed to make delivery on customers' securities failed to deliver | | - |
| Fail to deliver of customers' securities not older than 30 calendar days | | - |
| Margin related to option contracts for customers | | - |
| | | <hr/> |
| Aggregate debit items | | <hr/> - |

| | | |
|-------------------|--|---------|
| Less 3% | | - |
| | | <hr/> |
| Total debit items | | <hr/> - |

| | | |
|---|----|-------------|
| RESERVE COMPUTATION - Excess of total credits over total debits | \$ | <hr/> 1,364 |
|---|----|-------------|

| | | |
|--|----|-------------|
| AMOUNT ON DEPOSIT AT December 31, 2017 | \$ | <hr/> 2,508 |
|--|----|-------------|

No material differences exist between the above computation and the computation included in KGS-Alpha Capital Markets, L.P.'s corresponding Form X-17A-5 Part IIA filed on January 24, 2018.

KGS-ALPHA CAPITAL MARKETS, L.P.

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKERS AND DEALERS PURSUANT TO RULE 15c3-3 UNDER THE SECURITIES EXCHANGE ACT OF 1934

AS OF DECEMBER 31, 2017

(Dollars in Thousands)

1 Customers' fully paid securities and excess margin securities not in the Company's possession or control as of December 31, 2017, (for which instructions to reduce to possession or control had been issued as of December 31, 2017, but for which the required action was not taken by the Company within the time frames specified under Rule 15c3-3).

| | |
|--------------------|------|
| A. Market value | \$ - |
| B. Number of Items | None |

2 Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of December 31, 2017, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

| | |
|--------------------|------|
| A. Market value | \$ - |
| B. Number of Items | None |

No material differences exist between the above computation and the computation included in KGS-Alpha Capital Markets, L.P.'s corresponding Form X-17A-5 Part IIA filed on January 24, 2018.

KGS-ALPHA CAPITAL MARKETS, L.P.

FORMULA FOR DETERMINATION OF PAB ACCOUNT RESERVE REQUIREMENTS FOR BROKERS AND DEALERS UNDER RULE 15C3-3 AS OF DECEMBER 31, 2017 (Dollars in Thousands)

CREDIT BALANCES

| | | |
|---|----|---------|
| Free credit balances and other credit balances in PAB security accounts | \$ | - |
| Monies borrowed collateralized by securities carried for the accounts of PAB | | - |
| Monies payable against PAB securities loaned | | - |
| PAB securities failed to receive | | - |
| Credit balances in firm accounts which are attributable to principal sales to PAB | | - |
| Market value of short securities and credits in all suspense accounts over 30 calendar days | | - |
| | | <hr/> |
| Total PAB credits | | <hr/> - |

DEBIT BALANCES

| | | |
|---|----|---------|
| Debit balances in PAB cash and margin accounts excluding unsecured accounts and accounts doubtful of collection | | - |
| Securities borrowed to effectuate short sales by PAB and securities borrowed to make delivery on PAB securities failed to deliver | | - |
| Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in PAB accounts | | - |
| | | <hr/> |
| Total PAB debits | | <hr/> - |
| Excess of Total PAB credits over Total PAB debits | | - |
| PAB Reserve | | <hr/> - |
| Amount held on deposit in "Reserve Bank Account" at December 31, 2017 | \$ | <hr/> - |
| Amount of deposit | | <hr/> - |
| Amount held on deposit in "Reserve Bank Account" at January 3, 2018 | \$ | <hr/> - |

There are no differences noted per PAB schedule and filed FOCUS report.



KGS-ALPHA CAPITAL MARKETS

KGS-Alpha Capital Market, L.P.'s Exemption Report

KGS-Alpha Capital Markets, L.P. (the "Company") is a registered broker-dealer subject to Rule 17a-5 promulgated by the Securities and Exchange Commission (17 C.F.R. §240.17a-5, "Reports to be made by certain brokers and dealers"). This Exemption Report was prepared as required by 17 C.F.R. § 240.17a-5(d)(1) and (4). Although the Company does not fit into one of the identified exemptive provisions in 17 C.F.R. §240.15c3-3(k), consistent with Footnote 74 of the adopting release for the Rule 17a-5 amendments, the Company may file this Exemption Report because the Company did not maintain customer cash or margin accounts, did not hold customer free credit balances, and did not hold customer securities in safekeeping and self-cleared its financing transactions and a portion of its proprietary trading and customer business on a Delivery vs. Payment / Receive vs. Payment ("DVP/RVP") basis, while introducing the remainder of its proprietary trading and its customer transactions through another dealer on a fully disclosed basis (collectively the "identified circumstances"). The Company has discussed the basis for filing this Exemption Report with the SEC staff and this Exemption Report is consistent with those discussions.

To the best of its knowledge and belief, the Company met the identified circumstances described in the preceding paragraph throughout the year ended December 31, 2017 without exception.

KGS-Alpha Capital Markets, L.P.

I, Robert P. Seery, affirm that, to my best knowledge and belief, this Exemption Report is true and correct.

By: 

Chief Financial Officer

February 23, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Partners of
KGS-Alpha Capital Markets, L.P.
New York, New York

We have reviewed management's statement, included in the accompanying KGS-Alpha Capital Markets L.P.'s Exemption Report ("Exemption Report") in which KGS-Alpha Capital Markets L.P. (the "Company") stated that the Company met the identified circumstances, as defined in the Exemption Report, during the fiscal year ending December 31, 2017 without exception. The Company's management is responsible for its statement.

Our review was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and, accordingly, included inquiries and other required procedures to obtain evidence about management's statement that the Company met the identified circumstances, as defined in the Exemption Report. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's statement. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to management's statement referred to above for it to be fairly stated, in all material respects.

Deloitte + Touche LLP

February 23, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON APPLYING AGREED-UPON PROCEDURES

To the Partners of
KGS-Alpha Capital Markets, L.P.
New York, New York

We have performed the procedures enumerated below, which were agreed to by KGS-Alpha Capital Markets L.P. (the "Company") and the Securities Investor Protection Corporation (SIPC) (the "specified parties"), solely to assist the specified parties with respect to evaluating the Company's compliance with the applicable SIPC instructions as it relates to the accompanying General Assessment Reconciliation (Form SIPC-7) for the year ended December 31, 2017, and in accordance with Rule 17a-5(e)(4) of the Securities Exchange Act of 1934 and the SIPC Series 600 Rules.

Management is responsible for the Company's compliance with those requirements. This agreed upon procedures engagement was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures we performed and our findings are as follows:

1. Compared the listed assessment payments in Form SIPC-7 with respective cash disbursement records entries noting no differences;
2. Compared the total revenue amounts reported on the audited Form X-17A-5 for the year ended December 31, 2017, with the amounts reported in Form SIPC-7 for the year ended December 31, 2017, noting no differences;
3. Compared any adjustments reported in Form SIPC-7 with supporting schedules and working papers, noting no differences;
4. Proved the arithmetical accuracy of the calculations reflected in Form SIPC-7 and in the related schedules and working papers supporting the adjustments noting no differences.

We were not engaged to and did not conduct an examination or a review, the objective of which would be the expression of an opinion or conclusion, respectively, on the Company's compliance with the applicable SIPC instructions as it relates to the General Assessment Reconciliation (Form SIPC-7) for the year ended December 31, 2017. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified parties and is not intended to be, and should not be, used by anyone other than the specified parties.

Deloitte & Touche LLP

February 23, 2018

SIPC-7

(35-REV 6/17)

SECURITIES INVESTOR PROTECTION CORPORATION

P.O. Box 92185 Washington, D.C. 20090-2185

202-371-8300

General Assessment Reconciliation

SIPC-7

(35-REV 6/17)

For the fiscal year ended 2017

(Read carefully the instructions in your Working Copy before completing this Form)

TO BE FILED BY ALL SIPC MEMBERS WITH FISCAL YEAR ENDINGS

1. Name of Member, address, Designated Examining Authority, 1934 Act registration no. and month in which fiscal year ends for purposes of the audit requirement of SEC Rule 17a-5:

KGS-ALPHA CAPITAL MARKETS, LP
 521 5th Ave, 3rd floor
 New York, NY 10175

Note: If any of the information shown on the mailing label requires correction, please e-mail any corrections to form@sipc.org and so indicate on the form filed.

Name and telephone number of person to contact respecting this form.

Robert Seery (646) 588-2170

2. A. General Assessment (item 2e from page 2) \$ 292,425
- B. Less payment made with SIPC-6 filed (exclude interest) 137,142
8-01-2017
 Date Paid
- C. Less prior overpayment applied ()
- D. Assessment balance due or (overpayment) 155,283
- E. Interest computed on late payment (see instruction E) for 0 days at 20% per annum
- F. Total assessment balance and interest due (or overpayment carried forward) \$ 155,283
- G. PAYMENT: ☒ the box
 Check mailed to P.O. Box ☐ Funds Wired ☒
 Total (must be same as F above) \$ 155,283
- H. Overpayment carried forward \$()

3. Subsidiaries (S) and predecessors (P) included in this form (give name and 1934 Act registration number):

The SIPC member submitting this form and the person by whom it is executed represent thereby that all information contained herein is true, correct and complete.

Dated the 26th day of February, 20 18.

KGS Alpha Capital Markets, L.P.
 (Name of Corporation, Partnership or other organization)
Robert P. Seery
 (Authorized Signature)
CFO
 (Title)

This form and the assessment payment is due 60 days after the end of the fiscal year. Retain the Working Copy of this form for a period of not less than 6 years, the latest 2 years in an easily accessible place.

SIPC REVIEWER

Dates:

Postmarked

Received

Reviewed

Calculations

Documentation

Forward Copy

Exceptions:

Disposition of exceptions:

DETERMINATION OF "SIPC NET OPERATING REVENUES" AND GENERAL ASSESSMENT

Amounts for the fiscal period
beginning 1/1/2017
and ending 12/31/2017

| Item No. | Eliminate cents |
|---|------------------------|
| 2a. Total revenue (FOCUS Line 12/Part IIA Line 9, Code 4030) | \$ 299,363,254 |
| 2b. Additions: | |
| (1) Total revenues from the securities business of subsidiaries (except foreign subsidiaries) and predecessors not included above. | 0 |
| (2) Net loss from principal transactions in securities in trading accounts. | 28,259,112 |
| (3) Net loss from principal transactions in commodities in trading accounts. | 6,886,129 |
| (4) Interest and dividend expense deducted in determining item 2a. | 12,702,646 |
| (5) Net loss from management of or participation in the underwriting or distribution of securities. | 0 |
| (6) Expenses other than advertising, printing, registration fees and legal fees deducted in determining net profit from management of or participation in underwriting or distribution of securities. | 0 |
| (7) Net loss from securities in investment accounts. | 0 |
| Total additions | 47,847,887 |
| 2c. Deductions: | |
| (1) Revenues from the distribution of shares of a registered open end investment company or unit investment trust, from the sale of variable annuities, from the business of insurance, from investment advisory services rendered to registered investment companies or insurance company separate accounts, and from transactions in security futures products. | 0 |
| (2) Revenues from commodity transactions. | 5,584,393 |
| (3) Commissions, floor brokerage and clearance paid to other SIPC members in connection with securities transactions. | 4,457,550 |
| (4) Reimbursements for postage in connection with proxy solicitation. | 0 |
| (5) Net gain from securities in investment accounts. | 0 |
| (6) 100% of commissions and markups earned from transactions in (i) certificates of deposit and (ii) Treasury bills, bankers acceptances or commercial paper that mature nine months or less from issuance date. | 00 |
| (7) Direct expenses of printing advertising and legal fees incurred in connection with other revenue related to the securities business (revenue defined by Section 16(9)(L) of the Act). | 0 |
| (8) Other revenue not related either directly or indirectly to the securities business. (See Instruction C): | 0 |
| (Deductions in excess of \$100,000 require documentation) | |
| (9) (i) Total interest and dividend expense (FOCUS Line 22/PART IIA Line 13, Code 4075 plus line 2b(4) above) but not in excess of total interest and dividend income. | \$ 142,218,975 |
| (ii) 40% of margin interest earned on customers securities accounts (40% of FOCUS line 5, Code 3960). | \$ 0 |
| Enter the greater of line (i) or (ii) | 142,218,975 |
| Total deductions | 152,260,918 |
| 2d. SIPC Net Operating Revenues | \$ 194,950,223 |
| 2e. General Assessment @ .0015 Rate effective 1/1/2017 | \$ 292,425 |
| | (to page 1, line 2.A.) |