

KINGSWAY FINANCIAL SERVICES INC
Form 40-F
April 02, 2010

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 40-F

[Check one]

Registration Statement Pursuant to Section 12 of the Securities Exchange Act of 1934

or

Annual Report Pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended: December 31, 2009

Commission File Number: 1-15212

KINGSWAY FINANCIAL SERVICES INC.

(Exact name of Registrant as specified in its charter)

Ontario	6331	Not Applicable
(Province or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number, if applicable)

7120 Hurontario Street, Suite 800, Mississauga, Ontario, Canada L5W 0A9
(905) 677-8889

(Address and telephone number of Registrant's principal executive offices)

Kelly Marketti
Kingsway America Inc.
150 Northwest Point Blvd. 6th Floor Elk Grove Village, Illinois 60007
(847) 871-6400

(Name, address (including zip code) and telephone number (including area code) of
agent for service in the United States)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class
Common Shares,
no par value

Name of each exchange on which registered
New York Stock Exchange, Inc.

Securities registered or to be registered pursuant to Section 12(g) of the Act. N/A

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. N/A

For annual reports, indicate by check mark the information filed with this Form:

Annual information form Audited annual financial statements

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

51,595,828 Common Shares outstanding as of December 31, 2009

Indicate by check mark whether the Registrant by filing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"). If "Yes" is marked, indicate the filing number assigned to the Registrant in connection with such Rule.

Yes 82-_____ No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

KINGSWAY FINANCIAL SERVICES INC.

DOCUMENTS FILED UNDER COVER OF THIS FORM

Item	Description	Sequential Page Number
1.	Annual Information Form dated March 31, 2010 for the year ended December 31, 2009.	1
2.	Audited Consolidated Financial Statements of the Registrant for the fiscal years ended December 31, 2009 and 2008, including a reconciliation of U.S. and Canadian generally accepted accounting principles.	28
3.	Management's Discussion and Analysis of Financial Condition and Results of Operations.	91

ANNUAL INFORMATION FORM
FOR THE YEAR ENDED DECEMBER 31, 2009

KINGSWAY FINANCIAL SERVICES INC.

March 31, 2010

		Page
1.	CORPORATE STRUCTURE	4
2.	GENERAL DEVELOPMENT OF THE BUSINESS	6
3.	NARRATIVE DESCRIPTION OF THE BUSINESS	10
4.	DIVIDEND POLICY	13
5.	DESCRIPTION OF CAPITAL STRUCTURE	13
6.	MARKET FOR SECURITIES	15
7.	DIRECTORS AND EXECUTIVE OFFICERS	16
8.	LEGAL PROCEEDINGS AND REGULATORY ACTIONS	19
9.	INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS	20
10.	AUDIT COMMITTEE INFORMATION	20
11.	TRANSFER AGENT AND REGISTRAR	21
12.	INTERESTS OF EXPERTS	22
13.	MATERIAL CONTRACTS	22
14.	ADDITIONAL INFORMATION	22
	APPENDIX A	24

CURRENCY AND OTHER INFORMATION

Information in this Annual Information Form ("AIF") is as of December 31, 2009, unless otherwise specified. All of the dollar amounts in this AIF are expressed in U.S. dollars, except where otherwise indicated. References to "dollars" or "\$" are to U.S. dollars and any references to "C\$" are to Canadian dollars.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this AIF contain written "forward-looking statements" that are subject to risks and uncertainties. Forward-looking statements include, among others, statements regarding the objectives of Kingsway Financial Services Inc. ("KFSI", "Kingsway" or the "Company") and the strategies to achieve such objectives. These statements relate to future events or future performance and reflect management's current expectations and assumptions. The words "anticipate", "expect", "believe", "may", "should", "estimate", "project", "outlook", "forecast" or similar are used to identify such forward-looking statements. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management of the Company. A number of factors could cause actual events, performance or results to differ materially from the events, performance and results discussed in the forward-looking statements. For information identifying important factors that could cause actual results to differ materially from those anticipated in the forward looking statements, see Kingsway's securities filings, including its 2009 Annual Management's Discussion and Analysis, under the heading Risk Factors. The securities filings can be accessed on the Canadian Securities Administrators' website at www.sedar.com, and on the EDGAR section of the U.S. Securities and Exchange Commission's website at www.sec.gov or through the Company's website at www.kingsway-financial.com.

1. CORPORATE STRUCTURE

Kingsway Financial Services Inc. (“KFSI”, “Kingsway” or the “Company”) is the holding company for all of our subsidiaries.

In 2009, Kingsway carried on business through the following subsidiaries in the United States: American Country Insurance Company (“American Country”); American Service Insurance Company, Inc. (“American Service”); Lincoln General Insurance Company (“Lincoln General”) (disposed of in 2009); U.S. Security Insurance Company (“U.S. Security”); Mendota Insurance Company (“Mendota”); Mendakota Insurance Company (“Mendakota”); Southern United Fire Insurance Company (“Southern United”) (placed in voluntary run-off in 2009 and merged into American Service in 2010); Universal Casualty Company and Zephyr Insurance Company, Inc (“Zephyr”) (disposed of in 2009). Kingsway America (“Kingsway America”) is the holding company for all of our U.S. operating insurance subsidiaries.

In 2009, Kingsway carried on business through the following subsidiaries in Canada: Kingsway General Insurance Company (“Kingsway General”) (assets and liabilities assumed by JEVCO in 2009) and Jevco Insurance Company (“JEVCO”). On January 25, 2010, Kingsway announced that it had entered into a definitive purchase agreement to sell all of the outstanding shares of JEVCO to The Westaim Corporation (“Westaim”). On March 29, 2010 the sale of Westaim was completed as described further in the section below entitled “General Development of the Business - Jevco Insurance Company”.

We also have wholly-owned reinsurance subsidiaries domiciled in Bermuda and Barbados (all related party reinsurance treaties were commuted in 2009) and two wholly-owned insurance agencies in the U.S.: Avalon Risk Management Inc. (“Avalon”) (substantially all of the assets sold in 2009 as described further in the section below entitled “General Development of the Business - Avalon Risk Management Inc.”).

Name, Address and Incorporation

Kingsway was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. On November 10, 1995, Kingsway filed articles of amendment deleting its private company share restrictions, subdividing its outstanding common shares on a three-for-one basis, and deleting the Class A Special Shares and the Class B Special Shares that were previously authorized. On October 11, 1996, Kingsway filed articles of amendment to subdivide the common shares on a two-for-one basis. On April 27, 1998, Kingsway filed articles of amendment to subdivide the common shares on a two-for-one basis.

The head and registered office of Kingsway is located at 7120 Hurontario Street, Suite 800, Mississauga, Ontario, Canada, L5W 0A9.

Inter-Corporate Relationships

KFSI's subsidiaries and their inter-corporate relationship with KFSI are identified in the following diagram, and are also described in Note 2 to the 2009 annual consolidated financial statements of KFSI (the "Consolidated Financial Statements"), which Note is incorporated herein by reference. The Consolidated Financial Statements are available on SEDAR at www.sedar.com. All subsidiaries are 100% owned by the Company, directly or indirectly.

Inter-corporate Relationship Table

DE means Delaware, USA
CT means Connecticut, USA
TX means Texas, USA
MN means Minnesota, USA
FL means Florida, USA
AL means Alabama, USA
IL means Illinois, USA
WA means Washington, USA

2. GENERAL DEVELOPMENT OF THE BUSINESS

Three Year History

In 2007, Kingsway engaged in several transactions to raise capital and to build its non-standard insurance business. In 2008, Kingsway commenced a consolidation of its operations as the changing market underscored the fact that Kingsway lacked the flexibility to stay competitive. In early 2009, the consolidation accelerated as the Company moved toward a streamlined structure aimed at delivering operational efficiencies while maintaining geographic focus. This accelerated plan included the process of evaluating the profitability of every line of business with a focus on exiting non-core and unprofitable lines, determining which products and distribution channels would best position the Company for future growth, and aligning the cost base revenues.

The following disclosure describes events that have influenced the general development of the business of KFSI over the last three financial years. Particular focus has been given to certain significant transactions that have occurred in the 2009 financial year that materially affected the Company.

Lincoln General Insurance Company

In 2006, the company experienced significant adverse reserve development at its Lincoln General subsidiary. In 2007, a change in methodology and process used in estimating future claim liabilities added to this adverse reserve development. The adverse reserve development experienced by Lincoln General from the period 2007 to September 30, 2009 was approximately \$504.3 million.

In the year ended December 31, 2008, there was a 55% reduction in trading business written at Lincoln General through the elimination of unprofitable programs and the loss of business resulting from A.M. Best downgrades.

On May 29, 2009, the Pennsylvania Insurance Department (the "DOI") approved Lincoln General's run-off plan. This confidential document outlined Lincoln General's plan to accomplish a voluntary, solvent run-off providing for an orderly, efficient resolution and payment of all policy-related and other obligations. Included in this plan was the commutation of all reinsurance previously placed with affiliate Kingsway Reinsurance Corporation (Barbados). The commutation of this reinsurance was formerly approved by the DOI via a Form D filing.

On October 19, 2009, KFSI announced that Kingsway America had disposed of its entire interest in its wholly-owned subsidiary Walshire General Assurance Company ("Walshire"). Walshire is the sole shareholder of Lincoln General. All of the stock of Walshire was donated to charity, and with this disposition Lincoln General ceased being a member of the Kingsway group of companies. Kingsway is of the view that disposing of Lincoln General provided all stakeholders, including policyholders, shareholders and creditors with improved long-term value and was consistent with Kingsway's prior determination that it would not continue to voluntarily fund Lincoln General's reserve shortfalls. This disposition also assisted Kingsway in continuing to meet its regulatory and contractual obligations in respect of Lincoln General.

The extent of the Company's obligations in connection with Walshire and its subsidiaries are: a \$10 million cash contribution to Lincoln General (which was made in the fourth quarter of 2009); continued compliance with a run-off management agreement, including certain continued support to the run-off management team at Lincoln General; and continuing guarantee and reinsurance obligations to inter-company and third party insurance providers in respect of certain Lincoln General obligations.

- The net assets of Walshire were written down to \$nil, resulting in an after tax gain of \$1.5 million.

On November 16, 2009 the DOI announced its intent to take legal action to unwind the donations on the basis that such donations required DOI consent. Via press release dated November 16, 2009, KFSI announced that it disagreed with the DOI's position. Kingsway maintains the view that the donations of the Walshire shares to the charities were lawfully made and that the DOI has no legal basis for demanding the unwinding of the donations. Kingsway further believes that any assertion by the DOI that the donations did not comply with law, or any suggestion that there could be any "repercussions" for the charities which received the lawful donations, are not only incorrect but also inappropriate. KFSI confirmed that while the Company was open to continuing discussions with the DOI with a view to reaching a mutually agreeable solution, KFSI was also prepared to defend its lawful right to dispose of the Walshire shares as it has done and would vigorously defend its position if required to do so. KFSI also reconfirmed that it had met, and fully intended to continue meeting, its regulatory and contractual obligations in respect of Lincoln.

On November 19, 2009, KFSI asked the Commonwealth Court of Pennsylvania to declare that the October 19, 2009 donation of shares of the holding company of Lincoln General was lawful and did not require prior approval of the DOI.

On November 20, 2009 the DOI filed its own action in an attempt to challenge the disposition of Lincoln General.

The Company has demurred to each of the claims in the DOI's complaint, thereby putting the legal sufficiency of the DOI's claims at issue. The demurrers were argued to a panel of the Commonwealth Court on February 9, 2010.

Please refer to the section "Legal Proceedings and Regulatory Actions" of this AIF for further discussion relating to this legal proceeding which remains open.

Jevco Insurance Company

On September 23, 2009, KFSI announced that JEVCO would assume the assets and liabilities of Kingsway General on October 1, 2009 effectively consolidating the Company's Canadian business.

On November 23, 2009, as part of the Company's overall business transformation plan, and operational developments resulting from the downgrade in KFSI's rating by A.M. Best, the Company announced its intention to dispose of its majority interest in JEVCO.

On January 25, 2010, the Company announced that it had entered into a definitive purchase agreement with Westaim, for the sale of all of the issued and outstanding shares of JEVCO to Westaim for an aggregate purchase price of approximately 94.5% of the book value of JEVCO as at December 31, 2009. Please refer to the section entitled "Material Contracts" of this AIF for further discussion related to this transaction. On March 29, 2010, the sale to Westaim was completed.

A portion of the proceeds of sale was used to purchase sufficient Company indebtedness to ensure that KFSI continues to satisfy all financial covenants contained in bond agreements to which the Company and its affiliates are party. Please refer the section entitled "Description of Capital Structure - Debt Securities" for additional discussion.

Zephyr Insurance Company, Inc.

On September 9, 2009, KFSI announced that it had entered into a definitive agreement to sell Zephyr to Zephyr Acquisition Company, an acquisition vehicle of Ocean Harbor Holding Inc. and MP Holdings LLC, a Hawaiian based investor group with an expected completion date during the fourth quarter of 2009 subject to the receipt of regulatory approvals.

On October 30, 2009 KFSI announced that the sale of Zephyr was completed for initial gross proceeds of \$31.5 million U.S., plus a contingent, deferred earn-out amount.

Avalon Risk Management Inc.

On October 19, 2009, KFSI announced the completion of the sale of substantially all of the assets of Avalon, in furtherance of its focus on its core business. Avalon's assets and liabilities were sold to FMG Specialty Insurance Agency LLC for consideration equal to \$1.5 million, paid in cash and a note.

Business Transformation Plan

The Company continued to progress with its strategic transformation plan:

In April 2009, the Company launched a strategic transformation process with the objectives of aligning the organization around historically profitable core lines of business and to achieve an annualized savings run-rate of \$120,000,000 by year-end 2010.

On August 7, 2009, KFSI provided an update on the Company's strategic transformation process along with the announcement of its Q2 2009 financial results. Highlights from this update include confirmation that the Company had largely completed the process of aligning the employee population in the U.S. with the new operating model, applying a disciplined and rigorous approach to getting people with the right skills and experience in the right roles to drive a successful turnaround of the business. Support functions, including human resources, information technology and corporate legal, across the organization were consolidated to reduce duplication and eliminate unnecessary costs. Staff were reduced by a further 165 in the quarter and \$14 million, or 40.2% of the 2009 expense savings target, were achieved in the quarter while incurring approximately \$10 million in transition costs.

On November 6, 2009, KFSI provided a further update on the Company's strategic transformation process along with the announcement of its Q3 2009 financial results. Staff were reduced by a further 240 in the quarter for a total of 850 year to date an additional \$11.3 million in cost savings in the quarter with a total of \$45 million for the year, substantially ahead of an originally communicated target of \$34.8 million for 2009.

- Due to the sale of assets, measuring progress of the original transformation targets is no longer applicable.

On January 4, 2010, the Company and its subsidiary Kingsway America Inc. acquired certain assets of Itasca Financial, LLC, ("Itasca") a property and casualty insurance industry advisory firm. The consideration for the assets purchased is equal to \$1.5 million cash and one million restricted common shares of the Company, payable in three annual instalments. Itasca remained integral to the strategic transformation process during 2009, including addressing the capital allocation issues, debt buyback initiative and the divestiture strategy. The acquisition of Itasca and its associated insurance expertise provides a critical resource to the Company in order to assist with its transformation plan.

Other Developments

The following is a summary of additional events that have occurred over the past three fiscal years and that have influenced the general development of the business:

In April 2007, the acquisition of Mendota for a purchase price of approximately \$51.1 million closed. The purchase of Mendota was financed through a combination of internal sources and KFSI's existing credit facilities. Mendota is a dedicated non-standard insurance provider licensed in 43 states and currently writes business in 19 states through a network of approximately 6,000 independent agency locations.

In July 2007, Kingsway 2007 General Partnership ("Kingsway GP"), a wholly-owned subsidiary of KFSI, completed a public offering of C\$100,000,000 principal amount of 6% senior unsecured debentures of Kingsway GP for net proceeds of approximately C\$99,188,000. The debentures are jointly and severally guaranteed by KFSI and Kingsway America. The guarantee of Kingsway America is an unsecured senior obligation of Kingsway America and ranks equally with all of Kingsway America's other unsecured senior indebtedness and ranks senior to all existing and future subordinated indebtedness of Kingsway America.

In December 2007, the previously issued C\$78 million of 8.25% unsecured senior debentures which had a maturity date of December 31, 2007, were redeemed.

In December 2007, the Company entered into a 365 day C\$70 million credit facility agreement, which supplemented the then existing \$175 million that was originally entered into in June 2006 and set to mature in June 2009. During 2008, the Company repaid all outstanding amounts under this facility and the facility was terminated.

In June 2008, two of the Company's insurance subsidiaries, American Country and American Service, were consolidated under common management to reduce overhead and realize cost savings for the Company.

In July 2008, all of the amounts outstanding under the Company's \$175 million credit facility that were set to mature in June 2009, were repaid. At the same time, the Company repaid C\$19.9 million of the C\$70 million outstanding under its 365 day credit agreement entered into in December 2007.

On September 30, 2008, the sale of York Fire and Casualty Insurance Company ("York Fire"), a former subsidiary of the Company, was completed for C\$95 million. Following the sale of York Fire, the Company repaid its remaining short-term bank debt of approximately \$48 million, with the balance of the proceeds applied to support growth in core business lines and for general corporate purposes.

In November 2008, two of the Company's insurance subsidiaries, Southern United and Hamilton Risk Management Company, were amalgamated under one management team to reduce overhead and realize cost savings for the Company.

In February 2009, the Company liquidated the majority of its investment portfolio holdings of common share equities, resulting in a realized loss of \$18.2 million.

On June 5, 2009, the board of directors of the Company (the "Board") authorized management to withdraw ratings provided by Standard & Poor's and by DBRS in connection with its outstanding debt and securities, including its outstanding debt and units of the Kingsway Limited Return of Capital Trust. This decision was taken as part of the Board's ongoing cost cutting strategy.

On June 26, 2009, KFS Capital LLC, an indirect wholly-owned subsidiary of the Company, commenced a take-over bid to acquire up to 1,000,000 preferred, retractable, cumulative units of Kingsway Linked Return of Capital Trust at a price per unit of C\$12.00 in cash. This offer expired on Tuesday, August 4, 2009 and 694,015 units were tendered. This tender was paid for using available cash.

Kingsway GP announced on July 14, 2009 the commencement of a modified “Dutch Auction” tender offer (the “2012 Offer”) for a portion of its outstanding Unsecured 6% Debentures due July 11, 2012 (the “2012 Debentures”). The 2012 Offer provided for a cash purchase of 2012 Debentures at a price per C\$1,000 principal amount of debentures of not less than C\$540 and not greater than C\$620, for a maximum aggregate purchase price to the offeror not to exceed C\$31 million (excluding accrued and unpaid interest). The 2012 Offer expired Friday, August 14, 2009 with valid tenders (that were not withdrawn) of C\$9,174,000 in aggregate principal amount of Debentures. Kingsway GP accepted for purchase all such tendered Debentures at the highest price specified of C\$620 per C\$1,000 principal amount. This tender was paid for using available cash. A further C\$6,915,500 par was purchased during 2009 outside of the tender offer.

By September 30, 2009, the Company had commuted all of the reinsurance treaties between its U.S. subsidiaries and Kingsway Reinsurance Corporation and as at October 1, 2009, the intercompany reinsurance treaties between the Company's Canadian operating units and Kingsway Reinsurance Corporation were commuted as well. This was in addition (and unrelated) to the reinsurance commutations effected in connection with Lincoln General's runoff plan.

In September, 2009, the Company launched the consolidated Personal Lines and Commercial Lines businesses in the U.S. under a single "Kingsway America Inc." marketing brand.

3. NARRATIVE DESCRIPTION OF THE BUSINESS

General

The Company provides innovative insurance solutions to manage speciality risks for individuals and businesses in the United States and, until the disposition of JEVCO, in Canada. The Company's primary business is non-standard automobile insurance. Non-standard automobile insurance is the insuring of drivers who do not qualify for standard automobile insurance coverage because of their payment history, driving record, place of residence, age, vehicle type or other factors. Other products offered by KFSI have included trucking insurance, commercial automobile insurance, commercial and personal property coverages, standard automobile insurance, motorcycle insurance and other specialty lines. As a result of the strategic transformation process implemented throughout 2009 along with the business entity dispositions described above, the Company's focus is limited to primarily U.S. private passenger non-standard automobile insurance going into 2010.

Certain information with respect to the operations of the Company is set out below. A detailed discussion of the Company's operations in the U.S. and Canada is included in the 2009 Management's Discussion and Analysis in the section entitled "Corporate Overview" which is incorporated by reference herein.

In 2009, non-standard automobile business was the largest business line for KFSI and accounted for 77% of KFSI's \$291.0 million of gross premiums written ("GPW") (GPW being the total premiums on insurance underwritten before deduction of reinsurance premiums ceded) in 2009.

KFSI's premium distribution by line and geographic areas is set out in Tables 1 and 2 of the 2009 Management's Discussion and Analysis to the Consolidated Financial Statements, which Note is incorporated herein by reference.

In addition to revenue derived from premiums earned, KFSI also derives revenue from premium financing and investment income. This revenue amounted to \$13.0 million in 2009 as compared to \$24.1 million in 2008.

The selected Supplemental Financial Information set out in the section entitled "Result of Continuing Operations" of the 2009 Management's Discussion and Analysis, which section is incorporated herein by reference, provides details of the GPW, underwriting profits, and key ratios from KFSI's insurance operations compared to industry results for the eight year period ending December 31, 2009.

Employees

As a result of the transformation program, including the sale of a number of operating subsidiaries, as at December 31, 2009 there were approximately 1,000 personnel supporting our continuing operations. None of our employees are represented by a labour union. We believe that we have good relations with our employees and we have never experienced a work stoppage. After the disposition of JEVCO, the Company currently employs 30 employees in Canada. As of April 1, 2010, there will be approximately 15 employees in Canada, mainly in administrative functions.

Liquidity and Capital Resources

As a holding company, Kingsway receives cash from its subsidiaries to meet its obligations generally in the form of dividends and management fees. The Company's insurance subsidiaries fund their obligations primarily through premiums written and investment income as well as maturities in the investment portfolio. A full discussion is included in the section entitled "Financial Condition - Liquidity and Capital Resources" of the 2009 Management's Discussion and Analysis, which section is incorporated herein by reference.

Investment Portfolio

The fair value of KFSI's investment portfolio, including cash, decreased 76.9% to \$0.6 billion as at December 31, 2009 from \$2.5 billion as at December 31, 2008. Adjusted for the discontinued operations the fair value of securities portfolio declined 18.37% to \$0.6 billion as at December 31, 2009, from \$0.7 billion as at December 31, 2008. Total realized yield on a pre-tax basis was 2.1% for the year compared with 3.1% for 2008. The investment portfolio as at December 31, 2009 and December 31, 2008 is comprised of assets from a number of different classes as reflected in Note 5 to the Consolidated Financial Statements and as set out in the 2009 Management's Discussion and Analysis, which sections are incorporated herein by reference.

Intangible Properties

If the Company does not perform well, or if the outlook for our Company is significantly lower than historical trends, we may be required to recognize an impairment of intangible properties which could have a material adverse effect on our results of operations and financial condition.

Goodwill represents the value the Company paid to acquire subsidiaries and other businesses over the fair value of their net identifiable assets at the date of acquisition. Intangible assets represent separately identifiable assets that provide future benefits such as our trade marks. The Company reviews these assets for potential impairment on a regular basis as described in Note 20 to the Consolidated Financial Statements, which Note is incorporated herein by reference.

As at December 31, 2009, the Company's total assets included approximately \$nil of goodwill and \$37.6 million of intangible assets. Please refer to the section entitled "Controls and Accounting Policies - Goodwill and Intangible Assets" in the 2009 Management's Discussion and Analysis, which section is incorporated herein by reference. Adverse changes in the global economy or our business may result in impairment of our intangible properties. Such impairments could have a material adverse effect our reported operating income and capitalization.

Competitive Position

The insurance industry is price competitive in all markets in which Kingsway's insurance subsidiaries operate. Kingsway's subsidiaries strive to employ disciplined underwriting practices with the objective of rejecting underpriced risks including terminating or repricing unprofitable business and focusing on good risks within specialty markets where limited competition allows for a good spread of risk and above average returns. The combined ratio of claims plus underwriting expenses compared to net premiums earned is the traditional measure of underwriting results of property and casualty companies. In any year when the ratio exceeds 100%, it generally indicates that unprofitable business has been underwritten. As a result of a thorough analysis for all lines of business in 2009, it was determined that many were not profitable and necessary steps were taken to re-price or exit these lines of business. Additional discussion is included on in the section entitled "Revenues - Premium Income and Competitive Factors" of the 2009 Management Discussion and Analysis, which section is incorporated herein by reference.

During 2009, KFSI's GPW decreased 28% to \$376.8 million compared to \$524.2 million in 2008. The decreases came primarily from the impact of terminations of unprofitable or non-core business programs and the continuing soft market conditions for virtually all lines of business KFSI writes. KFSI maintains the position that it is better to write less business at appropriate rate levels than to compete with other insurers at lower premiums to increase volume at the expense of higher combined ratios.

The specialty lines that comprise KFSI's core business require specialized skills in the areas of underwriting, distribution and claim handling. The higher risk nature of non-standard automobile insurance requires knowledge of the market overall as well as knowledge of this specific segment of the insurance population. KFSI has developed this specialized knowledge over the past ten years through both acquisition and experience. The process through which the Company reduced staff in 2009 recognized these particular requirements and retained within the remaining employees that specialized skills and knowledge required for the overall smaller scale of the Company's business. As a result, these specialized skill sets were maintained within the organization while at the same time the overall quality of staff was improved.

KFSI's business is positively correlated with the economic cycles in both the U.S. and Canada. Consequently, volume of premiums written in 2009 was depressed on a relative basis. KFSI's business includes a very large number of relatively small insureds spread across a large and diverse geographic area in Canada and the U.S. As a result, the Company's business is not overly dependent on any one contract or commitment. Some of KFSI's business is sensitive to ratings from third party agencies such as A.M. Best.

Reorganization

Business Re-Alignment:

In 2009, the Company's businesses were re-aligned under three business units: 1) Canadian Operations; 2) U.S. Non-Standard Auto; and 3) Emerging Markets in the U.S. The consolidation and disposition of KFSI's Canadian operations is described above in the section entitled "Three Year History". American Country, American Service, Mendota, Mendakota and Universal Casualty Corporation were aligned under the U.S. Non-Standard Auto Business Unit and Hamilton Risk Management remained under the management of the Emerging Markets Business Unit. This restructuring supported the strategic alignment necessary to implement the Company's transformation process and created both economies of scope and scale.

Corporate Group Restructuring:

In response to recent income tax changes in Canada and the U.S., and in order to simplify the structure through which KFSI holds, indirectly, the shares of Kingsway America, certain members of the corporate group of KFSI were reorganized as follows.

Kingsway U.S. Finance Partnership and Kingsway U.S. Tier II Finance Partnership were dissolved. Metro Claim Services Inc. was amalgamated with Kingsway Finance Nova Scotia, ULC to form Kingsway Nova Scotia Finance ULC, which was subsequently converted into a limited liability company, being Kingsway Nova Scotia Finance Inc.

A new corporation, Kingsway America II Inc. was incorporated under the laws of Delaware, to hold the shares of Kingsway America Inc.

Risk Factors

The risk factors faced by KFSI are described under the section entitled "Risk Factors" in the 2009 Management's Discussion and Analysis, which section is incorporated herein by reference. The discussion of factors under such section may not be exhaustive of all possible factors and other factors could also adversely affect the Company's results. All such factors should be considered carefully when making decisions with respect to the Company.

4. DIVIDEND POLICY

The ability of KFSI to pay dividends on the common shares is largely dependent upon its ability to receive dividends from its subsidiaries. The insurance subsidiaries are regulated and are required to maintain statutory capital in order to write insurance policies. Regulatory authorities may impose, from time to time, additional restrictions which may affect the actual amounts available to KFSI for the payment of dividends.

KFSI paid and declared cash dividends in the aggregate amount of C\$0.04 per share, C\$0.30 per share and C\$0.30 per share for the fiscal years ended December 31, 2009, 2008 and 2007, respectively. As of the date hereof, there has been no dividend declared for 2010. Any decision to pay dividends on KFSI's common shares in the future will be dependent upon the financial requirements of KFSI to finance future growth, the financial condition of KFSI and other factors which the Board may consider appropriate in the circumstances.

5. DESCRIPTION OF CAPITAL STRUCTURE

Common Shares

General Description of Capital Structure

The authorized capital of KFSI consists of an unlimited number of common shares, of which 52,095,828 common shares were outstanding as of March 31, 2010. All common shares have the same attributes, including the right to one vote per share.

On November 9, 2007, KFSI announced its intention to commence a normal course issuer bid ("NCIB") to repurchase up to 2,780,000 common shares, ending no later than November 12, 2008 and being no more than five percent of the total number of common shares outstanding. During this period, 591,900 common shares were repurchased at an average price of C\$12.21. On November 28, 2008, KFSI announced its intention to commence another NCIB to repurchase up to 2,753,426 common shares for the twelve month period commencing December 2, 2008 and ending no later than December 1, 2009 and being no more than 5% of the total number of common shares outstanding. For the period December 2, 2008 to July 28, 2009, the Company did not repurchase any common shares. On July 29, 2009, KFSI announced an amendment to its existing NCIB for common shares which ended on December 1, 2009 and authorized KFSI to repurchase up to 5,386,545 common shares. For the period July 29, 2009 to December 1, 2009, the Company repurchased 3,472,700 common shares at an average price of C\$3.77.

Change of Control

Many state insurance laws intended primarily for the protection of policyholders require advance approval by state insurance commissioners of any change in control of an insurance company that is domiciled (or, in some cases, having such substantial business that it is deemed to be commercially domiciled) in that state. "Control" is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or

of any company that controls a domestic insurance company. In addition, insurance laws in many states contain provisions that require prenotification to the insurance commissioners of a change in control of a non-domestic insurance company licensed in those states.

Any future transactions that would constitute a change in Control of the Company's U.S. insurance company subsidiaries, including a change of Control of KFSI, would generally require the party acquiring Control to obtain the prior approval by the insurance departments of the insurance subsidiaries' states of domicile or commercial domicile, if any, and may require pre-acquisition notification in applicable states that have adopted pre-acquisition notification provisions. Obtaining these approvals could result in material delay of, or deter, any such transaction.

The shareholder rights plan of KFSI dated February 12, 2004 was reconfirmed at the annual and special meeting of shareholders held on May 3, 2007 and expires on the earlier of: (i) the "Termination Time" (as defined in the plan) and (ii) the close of business on the date of the annual meeting of shareholders of the Company in 2010. The Board has elected not to put forward for approval by the shareholders a revised plan in the belief that not having a Shareholders Rights Plan is in the best interest of current and future shareholders.

Debt Securities

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of KFSI issued \$90.5 million of 30 year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the London interbank offered interest rate for three-month U.S. dollar deposits, plus spreads ranging from 3.85% to 4.20%, but during the period December 4, 2007 to January 8, 2009, the interest rates did not exceed 12.45% to 12.75%. KFSI has the right to call each of these securities at par anytime after five years from their issuance until their maturity.

On July 14, 2005, Kingsway Linked Return of Capital Trust ("KLROC Trust") completed its public offering of C\$78 million of 5.00% Kingsway Linked Return of Capital Preferred Units due June 30, 2015, of which the Company was a promoter. The net proceeds of the offering were used by KLROC Trust for a series of investments that included the purchase of a C\$74.1 million, 7.12% senior note due June 30, 2015 issued by an affiliate. On June 26, 2009, KFS Capital LLC, an indirect wholly-owned subsidiary of Kingsway, commenced a take-over bid (the "KLROC Offer") to acquire up to 1,000,000 preferred, retractable, redeemable, cumulative units of KLROC Trust at a price per unit of C\$12.00 in cash. The KLROC Offer expired on Tuesday, August 4, 2009 and 694,015 units were tendered. This tender was paid for using available cash. A further 136,500 units were purchased during 2009 outside of the KLROC Offer.

Kingsway America has a promissory note payable balance of approximately \$66.2 million with Kingsway ROC LLC, an affiliated Company. The note was issued on July 15, 2005 and bears interest at 7.37% annually. The note principal is payable on June 30, 2015.

On July 10, 2007, Kingsway GP issued C\$100 million senior unsecured debentures at 6% due on July 11, 2012. These debentures bear interest at a fixed rate of 6% per annum payable semi-annually from the date of issuance until July 11, 2012. During 2009, the Company repurchased debentures totalling an aggregate principal amount of C\$16.1 million. As at December 31, 2009 C\$83.9 million of this issue was outstanding. Subsequent to the year end, the Company entered into several debt repurchase trades, which were contingent upon the closing of the JEVCO sale transaction that was completed on March 29, 2010. The Company repurchased C\$37.5 million of par value of the senior unsecured debentures due 2012, which debentures which will be cancelled.

On January 29, 2004, Kingsway America completed the sale of \$100 million 7.50% senior notes due 2014. In March 2004 an additional \$25 million of these senior notes were issued. During 2008 and 2009 the Company repurchased \$17.5 million and \$7.0 million of par value, respectively, of this offering. As at December 31, 2009 \$100.5 million of

this issue remains outstanding. Subsequent to the year end, the Company entered into several debt repurchase trades, which were contingent upon the closing of the JEVCO sale transaction that occurred on March 29, 2010. The Company repurchased US\$47.9 million of par value of senior notes due 2014.

Kingsway GP announced on July 14, 2009 the commencement of a modified "Dutch Auction" tender offer (the "2012 Offer") for a portion of its outstanding Unsecured 6% Debentures due July 11, 2012 (the "2012 Debentures"). The 2012 Offer provided for a cash purchase of 2012 Debentures at a price per C\$1,000 principal amount of debentures of not less than C\$540 and not greater than C\$620, for a maximum aggregate purchase price to the offeror not to exceed C\$31 million (excluding accrued and unpaid interest). The 2012 Offer expired Friday, August 14, 2009 with valid tenders (that were not withdrawn) of C\$9,174,000 in aggregate principal amount of Debentures. Kingsway GP accepted for purchase all such tendered Debentures at the highest price specified of C\$620 per C\$1,000 principal amount. This tender was paid for using available cash. A further C\$6,915,500 par was purchased during 2009 outside of the tender offer.

In May 2009, the Board delegated to the Capital Committee of the Board the authority to repurchase debt of the Company up to a maximum of \$40 million. The Capital Committee of the Board has recommended that capital allocated for the buyback initiative that remained unused following the expiry of: (i) the 2010 Offer and (ii) the KLROC Offer be applied to the repurchase of Kingsway common shares pursuant to the Company's normal course issuer bid.

Ratings

On June 5, 2009, the Company withdrew all ratings provided by Standard & Poor's in connection with its outstanding securities as a part of its ongoing cost cutting strategy.

On June 5, 2009, the Company withdrew all ratings provided by DBRS as a part of its ongoing cost cutting strategy.

On September 8, 2009 A.M. Best downgraded the financial strength rating of Lincoln General to 'D' (Poor) and the issuer credit rating to "c" with a negative outlook.

On November 24, 2009, the Company announced that A.M. Best had downgraded the Company's issuer credit rating from "b-" to "ccc" and the downgrade of the financial strength ratings from "B" to "B-" for American Service Insurance Company Inc., JEVCO, Mendakota Insurance Company, Mendota Insurance Company, Southern United Fire Insurance Company, U.S. Security Insurance Company, Inc. and Universal Casualty Company.

The ratings received from rating organizations for securities of KFSI are described further under the section entitled "Risk Factors" in the 2009 Management's Discussion and Analysis, which section is incorporated herein by reference.

6. MARKET FOR SECURITIES

Trading Price and Volume

The common shares of KFSI are listed on the Toronto Stock Exchange (the "TSX") and the New York Stock Exchange (the "NYSE") (Symbol: KFS).

The following chart sets forth the high and low sales price and volume for the common shares of KFSI on the TSX (in Canadian dollars) and the NYSE (in US Dollars) for the periods so indicated:

2009	TSX			NYSE		
	High (C\$)	Low (C\$)	Volume	High (US\$)	Low (US\$)	Volume
January	7.25	5.82	1,489,574	6.06	4.73	470,840
February	6.64	2.25	4,592,633	5.06	1.75	1,800,183
March	2.82	1.67	7,902,131	2.25	1.28	2,182,184
April	2.73	2.33	3,346,874	2.30	1.88	1,189,532
May	3.11	2.58	3,234,484	2.81	2.15	896,726
June	3.97	3.33	2,534,859	3.58	2.87	863,079
July	3.96	2.69	1,955,730	3.41	2.30	1,080,922
August	3.85	3.18	4,394,218	3.58	2.92	539,794
September	5.00	3.78	3,680,084	4.70	3.42	658,089
October	4.90	4.11	2,592,274	4.64	3.81	559,265
November	4.11	1.37	15,709,279	3.88	1.31	4,899,565
December	2.08	1.15	14,963,536	2.01	1.09	4,907,856

7. DIRECTORS AND EXECUTIVE OFFICERS

The following tables and the notes thereto state the names of all directors and executive officers of the Company, all other positions or offices with the Company and its subsidiaries now held by them, their principal occupations or employment and the number of common shares and options to acquire common shares of the Company beneficially owned, directly or indirectly, by each of them, or over which they exert control or direction as of the date hereof.

Directors

The name, municipality of residence and principal occupation of each of the directors are, as of the date hereof, as set forth below. Such individuals have served as directors of KFSI since the dates set forth opposite their respective names and their respective terms as directors of KFSI shall expire at the next annual meeting of KFSI, scheduled to be held on May 27, 2010.

Name and Residence	Date First Elected as Director	Principal Occupation
Gregory Hannon(1)(4) Ontario, Canada	September 16, 2009	Vice President, Oakmont Capital Inc.
Terence Kavanagh(2)(3) Ontario, Canada	April 23, 2009	President, Oakmont Capital Inc.
Spencer L. Schneider(1)(4)(5) (Chairman) New York, USA	January 7, 2009	Attorney, Self-Employed
Colin Simpson(3)(5) Ontario, Canada	August 6, 2009	President and Chief Executive Officer, KFSI
Joseph Stilwell(1)(2)(3) New York, USA	April 23, 2009	Managing Partner, Stillwell & Associates, LP

(1) Member of Audit Committee

(2) Member of Compensation Committee

(3) Member of Investment and Capital Committee

(4) Member of Corporate Governance and Nominating Committee

(5) Member of Disclosure Committee

For the past five years, each director has been engaged in his current occupation or in other capacities within the same or a related entity.

16

Executive Officers

The name, municipality of residence and position held with KFSI of each of the officers, are, as of the date hereof, as set forth below:

Name and Residence	Position with the Company	Principal Occupation
Daniel Brazier(1) Ontario, Canada	Interim Chief Financial Officer and Treasurer	Consultant, Resources Global Professionals (a business consulting firm with services in areas including finance and accounting, human capital, information management, and internal audit)
Denis Cloutier Ontario, Canada	Vice President and Chief Actuary (Canadian Operations)	Vice President and Chief Actuary (Canadian Operations), KFSI
Leslie DiMaggio Alabama, USA	Vice President, Information Technology	Vice President, Information Technology, KFSI
Kathleen A. Howie(1)(2) Ontario, Canada	Vice President, General Counsel and Corporate Secretary	Vice President, General Counsel and Corporate Secretary, KFSI
Glenn Penny Ontario, Canada	Vice President, Insurance Operations	Vice President, Insurance Operations, KFSI
Anastassia Plitman(3) Ontario, Canada	Vice President, Corporate Internal Audit	Vice President, Corporate Internal Audit, KFSI
Colin Simpson Ontario, Canada	President and Chief Executive Officer	President and Chief Executive Officer, KFSI
Larry Swets Itasca, Illinois, USA	Executive Vice President, Corporate Development	Executive Vice President, Corporate Development, KFSI
Barbara E. Valinski Lancaster, Pennsylvania, USA	Vice President, Corporate Human Resources	Vice President, Corporate Human Resources, KFSI

(1) Member of Disclosure Committee

(2) As of March 31, 2010, Ms. Howie will cease to be an executive officer of KFSI.

(3) As of March 31, 2010, Ms. Plitman will cease to be an executive officer of KFSI.

Except as noted below, for the past five years, each executive officer has been engaged in his current occupation or in other capacities within the same or a related entity.

¶ Daniel Brazier joined KFSI as Interim Chief Financial Officer and Treasurer in 2009. Mr. Brazier is also currently a consultant for Resources Global Professionals, which position he has held since April 2007. He was Vice President Finance with CIBC from June 2004 until July 2006.

¶ Denis Cloutier joined KFSI in January 2001 as Chief Actuary and was promoted to Vice President and Chief Actuary, Canadian Operations in September 2006.

¶ Leslie DiMaggio originally joined KFSI in July 2000. From January 2008 to November 2008 she served as the President and Chief Executive Officer of Southern United, a subsidiary of the Company and was promoted to Vice President, Operational Effectiveness of KFSI in November 2008. In May 2009 Ms. DiMaggio was appointed Vice President, Information Technology of KFSI.

Kathleen Howie joined KFSI in December 2007. Prior thereto, Ms. Howie was a member of the office of the General Counsel of Chubb Insurance Company of Canada from September 2006 to December 2007. From September 2005 to August 2006 she was a member of the Corporate Legal Counsel department at RBC Insurance.

- Glenn Penny joined KFSI in September 2008. Prior thereto Glenn was the Vice President, Claims at RBC General Insurance, a Canadian personal and other specialty lines insurer from 1997 to 2008.

Anastassia Plitman joined KFSI in July 2007. Prior thereto, Ms. Plitman was the Director of the Internal Audit and Controls Practice for Jefferson Wells International in Canada from February 2005 to June 2007.

Colin Simpson was appointed as the Chief Executive Officer of the Company on April 23, 2009. Mr. Simpson has been with Kingsway since 2004, holding various positions, including Senior Vice-President and Chief Strategy Officer and Senior Vice President and Chief Operating Officer. During this period, he was also the President and Chief Executive Officer of York Fire, a subsidiary of Kingsway, until it was sold in 2008.

Larry Swets was appointed Executive Vice President, Corporate Development of KFSI in 2009. Prior to joining KFSI, Mr. Swets served as Managing Member for Itasca Financial LLC in from June 2005 until December 2009. Mr. Swets was Acting Chief Financial Officer of Risk Enterprise Management, Ltd. from November 2007 until December 2009, and Director Investments for Kemper Insurance between 1997 and 2005. Presently, Mr. Swets is also engaged as Managing Member of Fund Management Group, which position he has held since 2007.

Barbara Valinski was appointed Vice President Corporate Human Resources of the Company on June 22, 2009. Prior to that, she served as Vice President Human Resources for Lincoln General from May 23, 2005 until June 21, 2009. She was Market Director for Travel Time Travel Agency from November 2004 until May 22, 2005.

As a group, the directors and officers of KFSI own, directly or indirectly or exercise control or direction over 9,103,496 (17.5%) of the total outstanding common shares of KFSI as of March 31, 2010. The information as to shares owned indirectly or over which control or direction is exercised by the directors and officers, but which are not registered in their names, not being within the knowledge of KFSI, has been furnished by such directors and officers of KFSI.

Conflicts of Interest

To the knowledge of KFSI, no director or officer of KFSI has an existing or potential material conflict of interest with KFSI or any of its subsidiaries.

Cease Trade Orders, Penalties, Sanctions and Bankruptcies

To the knowledge of the Company, no director or executive officer of the Company is, as at the date of this AIF, or was within 10 years before the date of this AIF, a director, chief executive officer or chief financial officer of any company (including KFSI), that:

- (a) was subject to a cease trade order, an order similar to a cease trade order or an order that denied the relevant company access to any exemption under securities legislation that was in effect for a period of more than 30 consecutive days (an "Order") that was issued while the director or executive officer was acting in the capacity as director, chief executive officer or chief financial officer, or

(b) was subject to an Order that was issued after the director or executive officer ceased to be a director, chief executive officer or chief financial officer and which resulted from an event that occurred while that person was acting in the capacity as director, chief executive officer or chief financial officer.

To the knowledge of the Company, no director or executive officer or a shareholder holding a sufficient number of securities of the Company to affect materially the control of the Company:

(a) is, as at the date of this AIF, or has been within the 10 years before the date of this AIF, a director or executive officer of any company (including KFSI) that while that person was acting in the that capacity, or within a year of that person ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets; or

(b) has, within the 10 years before the date of the AIF, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold the assets of the director, executive officer or shareholder.

Except as disclosed below, to the knowledge of the Company, no director or executive officer or, to the knowledge of the Company, a shareholder holding a sufficient number of securities of the Company to affect materially the control of the Company has been subject to (a) any penalties or sanctions imposed by a court relating to securities legislation or by a securities regulatory authority or has entered into a settlement agreement with a securities regulatory authority; or (b) any other penalties or sanctions imposed by a court or regulatory body.

8. LEGAL PROCEEDINGS AND REGULATORY ACTIONS

The Pennsylvania DOI has challenged the disposition to charities of Walshire and its subsidiaries (please refer to the section entitled “General Development of the Business - Three Year History” this AIF for a description of this transaction). On November 20, 2009, the DOI filed a complaint in the Commonwealth Court of Pennsylvania (“Commonwealth Court”) against the Company, Kingsway America Inc. and Walshire, seeking a declaration that the disposition was unlawful and not valid. The Company disagrees with the DOI’s position and maintains that the donations of Walshire shares to the charities were lawful and valid.

On November 19, 2009, the day before the DOI’s complaint, the Company and KAI filed a complaint in the Commonwealth Court against the DOI seeking a declaration that the statute upon which the DOI principally relies did not apply to the donations. In response to the Company’s complaint, the DOI filed New Matter, a counterclaim. The Company has demurred to each of the claims in the DOI’s complaint, thereby putting the legal sufficiency of the DOI’s claims at issue.

The demurrers were argued to a panel of the Commonwealth Court on February 9, 2010. The DOI argued that three different Pennsylvania statutory provisions required that Kingsway and Kingsway America obtain the DOI’s approval before making the donations. Kingsway and Kingsway America argued that the three statutes did not apply to the transactions on various bases, being: (i) that no person or entity acquired control of Lincoln General in the transactions; (ii) Lincoln General was not a party to these transactions; and (iii) there was no plan of asset transfer of Lincoln General. The Commonwealth Court reserved its decision. The timing of the decision is unknown at this time.

If the demurrers are unsuccessful, the complaints would proceed through the courts in due course. If the courts ultimately do not find for the Company, they might revert control of Lincoln back to the Company, which would result in Lincoln's financial results being included with the Company's consolidated financial statements.

In addition, in connection with its operations, KFSI and its subsidiaries are, from time to time, named as defendants in actions for damages and costs allegedly sustained by plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal damages or expense in excess of amounts provided and KFSI does not believe that it will incur any significant additional loss or expense in connection with such actions.

9. INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

In the three most recently completed financial years and the current financial year of the Company, no director, executive officer, or, to the knowledge of the Company, no person or company that beneficially owns, controls or directs, directly or indirectly, more than 10% of any class or series of outstanding voting securities of the Company, or associate or affiliate of any foregoing, other than what is specified below, had or is expected to have any material direct or indirect transactions with the Company that materially affected or would materially affect the Company.

In the fourth quarter of 2009, American Physicians Assurance Corporation ("AP Assurance") agreed to provide the company with up to \$20 million to finance the potential repurchase of senior debt. Two of the members of the Board, Spencer Schneider and Joseph Stilwell, are also members of the board of American Physicians Capital Inc., of which AP Assurance is a subsidiary. Neither of these individuals participated in the negotiation of the facility or the discussion or approval of the facility at the board level of KFSI or AP Assurance. At the time of these negotiations, Mr. Stilwell had not yet been appointed to the Board. No funds were ever drawn on this facility and it was withdrawn on February 25, 2010.

10. AUDIT COMMITTEE INFORMATION

Composition of the Audit Committee

As of the date hereof, the Audit Committee of KFSI was composed of the following three members: Gregory Hannon (Chair), Spencer L. Schneider and Joseph Stilwell. The responsibilities and duties of the Audit Committee are set out in the Audit Committee's charter, the text of which is set forth in Appendix A to this AIF.

The Board believes that the composition of the Audit Committee reflected a high level of financial literacy and expertise. Each member of the Audit Committee has been determined by the Board to be "independent" and "financially literate" as such terms are defined under Canadian and United States securities laws and the NYSE rules. The Board has made these determinations based on the education and breadth and depth of experience of each member of the Audit Committee.

The following is a description of the education and experience of each member of the Audit that is relevant to the performance of his responsibilities as a member of the Audit Committee:

Gregory P. Hannon has been a Vice-President and Director of Oakmont Capital Inc. since 1997. He previously was a founding partner of Lonrisk, a Toronto-based specialty insurer and subsidiary of the London Insurance Group, where he was the Vice-President. Prior to that, Mr. Hannon worked for the Continental Bank of Canada in commercial credit and as auditor for Arthur Andersen and Company, Chartered Accountants. Mr. Hannon received a Bachelor of

Commerce degree from Queen's University in 1978 and an M.B.A. from The Harvard Business School in 1987. He currently sits on the Board of Delhi-Solac, a privately owned manufacturer of steel tubing.

Spencer L. Schneider has served, since 2002, on the audit committee of American Physicians Capital Inc. (“ACAP”), an insurance holding company, which is engaged in the business of providing medical professional liability insurance to physicians in the United States. In this role, Mr. Schneider has been actively involved in reviewing ACAP’s quarterly and annual filings.

Joseph Stilwell, as managing partner of Stilwell Associates, LP, has over 17 years of experience in managing his own investment funds, with a great deal of his time being dedicated to analyzing financial statements. Mr. Stilwell is also a graduate from the Wharton School of the University of Pennsylvania with a Bachelor of Science in Economics.

Auditor Service Fees

Aggregate fees paid to the Company's Auditors during the fiscal years ended December 31, 2009 and 2008 were as follows:

(in Canadian dollars)	2009 Fee Amount	2008 Fee Amount
Audit Fees	C\$3,791,931	C\$4,549,500
Audit-Related Fees	C\$175,000	C\$136,200
Tax Fees	C\$704,807	C\$397,300
All Other Fees	C\$2,000	C\$2,000
Total:	C\$4,673,738	C\$5,085,000

Audit Fees represent the aggregate fees billed by the Company’s external auditors for professional services rendered for the audit of the consolidated financial statements of the Company and its subsidiaries, and for the reviews of the Company’s quarterly financial statements.

Audit-Related Fees represent the aggregate fees billed by the Company’s external auditors for indirect audit services provided. These fees included consultations relating to financial accounting and reporting standards and French translation services.

Tax Fees represent the aggregate fees billed by the Company’s external auditors for tax services related to tax compliance, tax advice and tax planning. These services included analyses of various tax matters affecting the Company.

All Other Fees represent the aggregate fees billed by the Company’s external auditors for services other than Audit, Audit-Related and Tax. These services relate to a subscription for online accounting research.

11. TRANSFER AGENT AND REGISTRAR

KFSI's transfer agent and registrar is Computershare Investor Services Inc. at its principal office in Toronto, Ontario.

12. INTERESTS OF EXPERTS

Name of Experts

KPMG LLP prepared auditors' reports in regard to the Consolidated Financial Statements and in regard to the Company's internal control over financial reporting at December 31, 2009. The Canadian Institute of Chartered Accountants gives authority to the reports.

Pierre Laurin, of the Tillinghast insurance consulting business of Towers Watson & Co., prepared an actuary report in regard to the Consolidated Financial Statements. The Canadian Institute of Actuaries gives authority to the report.

Interests of Experts

KPMG LLP is independent with respect to the Company within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario and the rules of the U. S. Securities Exchange Commission.

Pierre Laurin, of the Tillinghast insurance consulting business of Towers Watson & Co. has advised that he is independent with respect to the Company within the meaning of the Rules of Professional Conduct of the Canadian Institute of Actuaries.

13. MATERIAL CONTRACTS

On June 29, 2009, the Company entered into a run-off management agreement with Rockwall Financial Advisors, LLP, an external run-off manager, to provide certain consulting services relating to Lincoln General, including advice and assistance in the development of a Run-off Plan. In addition to base compensation of \$1.3 million annually, the agreement provides for a minimum of \$2.5 million to be paid to the run-off manager at the termination of the contract (provided the contract is not terminated for cause), which, at the latest will be March 1, 2014.

On January 25, 2010, the Company, as seller, entered into a purchase agreement with Westaim, as purchaser. The agreement provides for the sale of all of the issued and outstanding shares in the capital of JEVCO to Westaim for a purchase price of approximately 94.5% of the book value of JEVCO as at December 31, 2009, subject to adjustments. The sale of JEVCO to Westaim closed on March 26, 2010. A portion of the proceeds from this transaction were used to repay outstanding indebtedness sufficient to lower the ratios applicable to the restrictive covenants to a level where the restrictions did not apply. This transaction is expected to improve the Company's capital flexibility and reduce the debt service costs required going forward.

14. ADDITIONAL INFORMATION

Financial information about the Company is contained in its Consolidated Financial Statements and Management's Discussion and Analysis for fiscal year ended December 31, 2009, which are available on SEDAR at www.sedar.com.

Additional information, including directors' and officers' remuneration and indebtedness, the principal holders of KFSI securities and securities authorized for issuance under equity compensation plans, where applicable, is contained in KFSI's latest proxy circular dated as of March 16, 2009 in connection with its annual meeting of shareholders held on April 23, 2009, which involved the election of directors.

Copies of this AIF Form as well as copies of the Management's Discussion and Analysis and the Consolidated Financial Statements for the year ended December 31, 2009 may be obtained from:

Kingsway Financial Services Inc.
c/o Colin Simpson
7120 Hurontario Street, Suite 800
Mississauga, Ontario
L5W 0A9

APPENDIX A

CHARTER OF THE AUDIT COMMITTEE

Kingsway Financial Services Inc

I. Purpose

The Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to (a) the integrity of the Company's financial statements, (b) the Company's compliance with legal and regulatory requirements, (c) the external auditor's qualifications and independence, and (d) the performance of the company's corporate internal audit department function and the performance of the external auditors. The Audit Committee's primary duties and responsibilities are to:

- (i) Identify and monitor the management of the principal risks that could impact the financial reporting of the company
- (ii) Monitor the integrity of the Company's financial reporting process and system of internal controls regarding financial reporting and accounting appropriateness and compliance.
- (iii) Recommend the appointment of and monitor the independence and performance of the company's external auditors and the external appointed actuary.
- (iv) Provide an avenue of communication among the external auditors, the external appointed actuary, management and the Board of Directors'.
- (v) Review the annual audited financial statements with management and the external auditors.

II. Organization

Audit Committee members shall meet the requirements of the Business Corporations Act (Ontario), all applicable securities laws, and the Toronto Stock Exchange and the New York Stock Exchange. The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be outside directors who are unrelated, free from any relationship that would interfere with the exercise of his or her independent judgment. All members of the Committee shall be financially literate, being defined as able to read and understand basic financial statements, and the Chair of the Committee shall have accounting or related financial management expertise. The Audit Committee shall assist the Board in determining whether or not one or more members of the Audit Committee is an "audit committee financial expert" as defined in SSEC Release 33-8177.

Audit Committee members shall be appointed by the Board annually at the meeting of the board of Directors next following the annual meeting. The Audit Committee Chair shall be designated by the full board or if it does not do so, the members of the Committee may designate a Chair by majority vote of the Committee membership.

III. Structure and Meetings

The Committee shall meet at least quarterly, or more frequently as circumstances dictate. The Audit Committee shall prepare and/or approve an agenda in advance of each meeting. The committee should meet privately in executive session with each of management, the external auditors, the external appointed actuary, the corporate internal auditor and as a committee to discuss any matters that the Committee or each of these groups believe should be discussed.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well any other employees or consultants to Kingsway and its subsidiaries. The Audit Committee has the ability to retain, at the Company's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

IV. Responsibilities and Duties

The Audit Committee shall have the power and authority of the Board of Directors to perform the following duties and fulfill the following responsibilities:

Review Procedures

1. Review and reassess the adequacy of this Mandate at least annually and submit the mandate to the Board of Directors for approval.
2. Review the Company's annual audited financial statements and discuss the Company's quarterly financial statements and related documents prior to filing or distribution. Review should include discussion with management and external auditors of significant issues regarding accounting principles, practice, and significant management estimates and judgments as well as the contents of "Management's Discussion and Analysis".
3. In consultation with management, external auditors, and external appointed actuary, consider the integrity of the Company's financial, reporting processes and internal controls. Discuss significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures. Review significant findings prepared by the external auditors together with management's responses.
4. Review the effectiveness of the overall process for identifying the principal risks affecting financial reporting and provide the Committee's view to the Board of Directors.
5. Review the Company's quarterly financial results and related documents prior to the release of earnings and/or the company's quarterly financial statements prior to filing or distribution shall be reviewed by the full Board of Directors.
6. Review financial statements and other related documents to be included in any prospectus or other offering document of the Company.
7. Discuss the Company's earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies.

External Auditors and Actuaries

8. The External auditors are accountable to the Audit Committee and the Board of Directors, as representatives of the shareholders. The Audit Committee shall review the independence and performance of the auditors and annually recommend to the Board of Directors the appointment of the external auditors or approve any discharge of auditors when circumstances warrant.
9. Recommend the appointment and approve the appointment, compensation and work carried out by the external auditors, including the provision of both audit related and non-audit related services.
10. On no less than an annual basis, the Committee should review and discuss with the external auditors all significant relationships they have with the Company that could impair the non-audit related services.
11. Review the external auditor's audit plan and in particular, discuss and approve audit scoping, staffing, locations, reliance upon management and general audit approach.
 12. On not less than an annual basis review with the external auditors:
 - (i) all critical accounting policies and practices to be used in connection with the auditor's report
 - (ii) all alternative treatments within GAAP for policies and practices related to material items that have been discussed with management, including ramification of the use of such alternative disclosures and treatments, and the treatment preferred by auditor; and
 - (iii) other material written communications between the auditor and the management of the Company, such as any management representation letter, schedule of unadjusted differences, reports on observations and recommendations on internal control, engagement letter and independence letter.
13. Prior to releasing the year-end earnings, discuss the results of the audit with the external auditors. Discuss certain matters required to be communicated to audit committees in accordance with the standards established by the Canadian Institute of Chartered Accountants.
14. Consider the external auditor's judgments about the quality and appropriateness of the Company's accounting principles as applied in the Company's financial reporting.
 15. Set clear hiring policies for employees or former employees of the external auditors.
16. Consider the external appointed actuary's judgment about the appropriateness of management's selection of assumptions of methods to determine the unpaid claims liabilities included in the company's year-end financial statements.

Corporate Internal Audit Department

17. Discuss policies with respect to risk assessment and risk management
18. On not less than an annual basis, obtain and review a report by the external auditor describing the Company's internal quality-control review, or peer review of the Company.
19. Review significant internal audit reports together with internal auditors and with external auditors.
20. Meet separately, periodically, with management, with internal auditors and with external auditors
21. Review formal whistleblower procedures that address the receipt, retention and treatment of complaints regarding accounting, internal controls and auditing matters and the confidential anonymous submission by employees of any concerns regarding questionable accounting or auditing matters.
22. On at least an annual basis, review with the Company's counsel any legal matters that could have a significant impact on the organization's financial statements, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.
23. Develop and recommend to the full Board a set of corporate governance principles, review such principles annually and recommend any modifications thereto.
24. Consider corporate governance issues that may arise from time to time and make recommendations to the Board with respect thereto.
25. Confer, as appropriate, with the General Counsel on matters of corporate governance.

Other Audit Committee Responsibilities

26. Annually assess the effectiveness of the committee against this Mandate and report the results of the assessment to the Board.
27. Perform any other activities consistent with this Mandate, the Company's by-laws and governing law, as the Committee or the board deems necessary or appropriate.
28. Maintain minutes of meetings and periodically report to the Board of Directors on significant results of the foregoing activities.
29. Establish, review, and update periodically a Code of Conduct of the CEO and other Senior Financial Officers and Code of Ethical Conduct for others and ensure that management has established a system to enforce these codes.
30. The Audit Committee will annually review a summary of director and officers' related party transactions and potential conflicts of interest.

Kingsway Financial Services Inc.

2009 Annual Report

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and have designed such internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles (GAAP), including a reconciliation to U.S. GAAP.

Management has used the Internal Control - Integrated Framework to assess the effectiveness of the Company's internal control over the financial reporting as of December 31, 2009, which is a recognized and suitable framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009 and has concluded that such internal control over financial reporting is effective as of December 31, 2009. There are no material weaknesses that have identified by management in this regard.

The independent registered public accounting firm, KPMG LLP, appointed by the Audit Committee and ratified by the shareholders, who have audited the consolidated financial statements, have also audited the internal control over financial reporting and have issued an attestation on the effectiveness of the Company's internal control over financial reporting.

Colin Simpson
President & Chief Executive Officer

Daniel Brazier
Chief Financial Officer

March 31, 2010

INTERNAL CONTROL OVER FINANCIAL REPORTING

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Kingsway Financial Services Inc.:

We have audited Kingsway Financial Services Inc.'s ("the Company's") internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles, including a reconciliation to United States generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have conducted our audits on the consolidated financial statements in accordance with Canadian generally accepted auditing standards. With respect to the consolidated financial statements for the year ended December 31,

2009, we also have conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our report dated March 31, 2010 expressed an unqualified opinion on those consolidated financial statements.

Chartered Accountants, Licensed Public Accountants
Toronto, Canada
March 31, 2010

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S STATEMENT ON RESPONSIBILITY FOR FINANCIAL INFORMATION

Management is responsible for presentation and preparation of the annual consolidated financial statements, Management's Discussion and Analysis ("MDA") of the financial condition and results of the operations and all other information in the Company's Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the United States Securities and Exchange Commission ("SEC") including a reconciliation to generally accepted accounting principles in the United States. Financial information appearing elsewhere in the Company's Annual Report is consistent with the consolidated financial statements.

The MDA has been prepared in accordance with the requirements of the applicable securities rules and regulations, including National Instrument 51-102 of the Canadian securities regulators as well as Item 303 of Regulation S-K of the Securities Exchange Act of the United States, and their related published requirements.

The consolidated financial statements and information in the MDA necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. In addition, in preparing the financial information management must make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. The MDA also includes information regarding the estimated impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because future events and circumstances may not occur as expected and we undertake no duty to update such forward-looking statements.

In meeting its responsibility for the reliability of the consolidated financial statements and for the accounting systems from which they are derived, management maintains the necessary system of internal controls. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, that assets are safeguarded against unauthorized use or disposition and that liabilities are recognized.

The Board of Directors oversees management's responsibilities for financial reporting through an Audit Committee, which is composed entirely of directors who are neither officers nor employees of the Company. The Audit Committee reviews the consolidated financial statements and recommends them to the board for approval. The Audit Committee also reviews and monitors the Company's system of internal controls as reported by management or the independent registered public accounting firm.

CONSOLIDATED FINANCIAL STATEMENTS

ROLE OF THE ACTUARY

With respect to the preparation of these financial statements, management prepares a valuation, including the selection of appropriate assumptions, of the Company's obligations at the balance sheet date under insurance policies issued by its subsidiaries. With respect to the preparation of these financial statements, the independent actuary, Pierre Laurin of Towers Watson, carries out a review of management's valuation of the estimated unpaid claim liabilities and provides an opinion to the Board of Directors regarding the appropriateness of the estimated unpaid claim liabilities recorded by management to meet all policyholder claim obligations of the Company at the balance sheet date. The work to form that opinion includes an examination of the sufficiency and reliability of data, and review of the valuation process used by management. In performing the review of these estimated liabilities determined by management, which are by their very nature inherently variable, the actuary makes assumptions as to future loss ratios, trends, reinsurance recoveries, expenses and other contingencies, and develops appropriate methodologies taking into consideration the circumstances of the Company and the nature of the insurance policies in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In carrying out its work, the independent actuary makes use of the work of the independent registered public accounting firm with regards to data upon which their calculations are based.

The valuation is based on projections of future claims and claim adjustment expenses on claims incurred at the balance sheet date. It is certain that actual future claims and claim adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, the projections make no provision for new classes or claim categories not sufficiently recognized in the claims database.

Management is responsible for the accuracy and completeness of the underlying data used in the valuation. The actuary's report outlines the scope of the review and the opinion.

ROLE OF THE AUDITOR

The independent registered public accounting firm, KPMG LLP, has been appointed by the Audit Committee and ratified by the shareholders. Its responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States) and to report thereon to the shareholders. In carrying out their audit procedures relating to the claims liabilities of the Company, the auditors make use of the work and report of the independent actuary. KPMG has full and unrestricted access to the Board of Directors and the Audit Committee to discuss audit, financial reporting and related findings. The auditors' report outlines the scope of their audit and their opinion.

President & Chief Executive Officer

Chief Financial Officer

March 31, 2010

32

CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Kingsway Financial Services Inc.:

We have audited the consolidated balance sheets of Kingsway Financial Services Inc. (the “Company”) as at December 31, 2009 and December 31, 2008 and the consolidated statements of operations, statements of changes in shareholders’ equity, comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. With respect to the consolidated financial statements for the years ended December 31, 2009 and 2008, we also conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and December 31, 2008 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2009 in conformity with Canadian generally accepted accounting principles.

Canadian generally accepted accounting principles vary in certain significant respects from U.S. generally accepted accounting principles. Information relating to the nature and effect of such differences is presented in Note 21 to the consolidated financial statements.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 31, 2010 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Chartered Accountants, Licensed Public Accountants
Toronto, Canada
March 31, 2010

CONSOLIDATED FINANCIAL STATEMENTS

ACTUARY'S REPORT

I have reviewed the unpaid claims liabilities of Kingsway Financial Services Inc. determined by management and recorded in its consolidated balance sheet at December 31, 2009 and 2008 and their changes in the consolidated statement of operations for each of the years in the three year period ended December 31, 2009 in accordance with Canadian accepted actuarial practice.

Under Canadian accepted actuarial practice, the valuation of unpaid claims liabilities reflects the time value of money. Management has chosen not to reflect the time value of money in determining the valuation of the unpaid claims liabilities in the consolidated financial statements.

In my opinion, except as described in the preceding paragraph, management's valuation of the unpaid claims liabilities is appropriate and the consolidated financial statements fairly present the results of the valuation.

Pierre Laurin, Towers Watson
Fellow Canadian Institute of Actuaries
March 31, 2010

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars)

As at December 31

	2009	2008
Assets		
Cash and cash equivalents	\$ 58,726	\$ 63,928
Securities (Note 5)	512,197	637,595
Accrued investment income	4,158	16,755
Financed premiums	15,237	16,533
Accounts receivable and other assets	94,285	133,167
Due from reinsurers and other insurers (Note 13)	4,938	15,795
Deferred policy acquisition costs	29,088	39,290
Income taxes recoverable	15,883	448
Future income taxes (Note 14)	9,481	15,840
Capital assets (Notes 1, 9)	30,308	31,511
Goodwill and intangible assets (Notes 1, 2(e), 20)	37,573	50,215
Assets held for sale (Notes 4, 27(b))	1,145,481	2,322,364
	\$ 1,957,355	\$3,343,441
Liabilities and Shareholders' Equity		
Liabilities:		
Loans payable (Note 17(d))	\$ 66,222	\$ 66,222
Accounts payable and accrued liabilities	61,041	81,467
Unearned premiums	120,657	163,111
Unpaid claims (Note 15)	368,501	374,799
Senior unsecured debentures (Notes 17(b), 27(b))	176,764	185,203
Subordinated indebtedness (Note 17(c))	87,415	87,383
Liabilities held for sale (Notes 4, 27(b))	907,416	1,931,684
	\$ 1,788,016	\$2,889,869
Shareholders' equity:		
Share capital (Note 10)	295,291	322,344
Contributed surplus	20,549	9,791
Retained earnings (deficit)	(193,572)	98,564
Accumulated other comprehensive income	47,071	22,873
	169,339	453,572
Contingent liabilities (Notes 4, 19)		
Subsequent events (Notes 4, 28)		
	\$ 1,957,355	\$3,343,441

See accompanying notes to consolidated financial statements.

On behalf of the Board:

/s/ Spencer Schneider
 Spencer Schneider
 Director

/s/ Greg Hannon
 Greg Hannon
 Director

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S. dollars, except per share amounts)

Years ended December 31

	2009	2008	2007
Gross premiums written	\$ 376,792	\$ 524,191	\$ 510,142
Net premiums written	\$ 385,638	\$ 510,008	\$ 503,171
Revenue:			
Net premiums earned (Note 13)	\$ 430,221	\$ 524,816	\$ 500,101
Net investment income (Note 5)	2,728	35,311	42,243
Net realized investment gains (losses) (Note 5)	10,248	(11,202)	2,207
	443,197	548,925	544,551
Expenses:			
Claims incurred (Notes 13 and 15)	355,905	372,682	357,132
Commissions and premium taxes (Note 13)	73,714	85,997	89,865
General and administrative expenses	110,484	109,570	97,745
Restructuring costs (Note 24)	14,783	-	-
Interest expense	23,912	35,022	38,868
Amortization of intangible assets (Note 1)	10,650	10,394	7,167
Goodwill impairment (Note 20)	-	50,074	-
	589,448	663,739	590,777
Loss from continuing operations before unusual item and income taxes	(146,251)	(114,814)	(46,226)
Gain on buy-back of debt (Note 17)	9,501	652	-
Loss from continuing operations before income taxes	(136,750)	(114,162)	(46,226)
Income taxes (recovery) (Note 14):			
Current	(32,702)	(10,835)	6,475
Future	2,292	39,440	(10,708)
	(30,410)	28,605	(4,233)
Loss from continuing operations	\$ (106,340)	\$ (142,767)	\$ (41,993)
Income (loss) from discontinued operations, net of taxes (Note 4)	(186,132)	(297,597)	23,467
Gain on disposal of discontinued operations, net of taxes (Note 4)	2,185	34,499	-
Net loss	\$ (290,287)	\$ (405,865)	\$ (18,526)
Per share amounts (in dollars) (Note 10):			
Loss per share - continuing operations			
Basic	\$ (1.97)	\$ (2.59)	\$ (0.74)
Diluted	\$ (1.97)	\$ (2.59)	\$ (0.74)
Loss per share - discontinuing loss			
Basic	\$ (3.41)	\$ (4.76)	\$ 0.42
Diluted	\$ (3.41)	\$ (4.76)	\$ 0.42
Loss per share - net loss			
Basic	\$ (5.38)	\$ (7.35)	\$ (0.32)
Diluted	\$ (5.38)	\$ (7.35)	\$ (0.32)
Dividends declared per common share (in Canadian dollars)	\$ 0.04	\$ 0.30	\$ 0.30

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands of U.S. dollars)

Years ended December 31

	2009	2008	2007
Share capital			
Balance at beginning of year	\$ 322,344	\$ 326,151	\$ 328,473
Issued during the year	-	89	1,082
Repurchased for cancellation	(27,053)	(3,896)	(3,404)
Balance at end of year	295,291	322,344	326,151
Contributed surplus			
Balance at beginning of year	\$ 9,791	\$ 7,619	\$ 5,352
Stock option adjustment	(4,186)	2,172	2,267
Repurchase of shares for cancellation	14,944	-	-
Balance at end of year	20,549	9,791	7,619
Retained earnings (deficit)			
Balance at beginning of year	\$ 98,564	\$ 521,165	\$ 560,126
Net loss for the year	(290,287)	(405,865)	(18,526)
Common share dividends	(1,849)	(15,460)	(15,710)
Repurchase of shares for cancellation	-	(1,276)	(4,725)
Balance at end of year	(193,572)	98,564	521,165
Accumulated other comprehensive income			
Balance at beginning of year	\$ 22,873	\$ 85,866	\$ 7,011
Cumulative effect of adopting new accounting policies	-	-	17,672
Other comprehensive income (loss) (Note 2(c))	24,198	(62,993)	61,183
Balance at end of year	47,071	22,873	85,866
Total shareholders' equity at end of year	\$ 169,339	\$ 453,572	\$ 940,801

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands of U.S. dollars)

Years ended December 31

	2009	2008	2007
Comprehensive income (loss)			
Net loss	\$ (290,287)	\$ (405,865)	\$ (18,526)
Other comprehensive income (loss), net of taxes:			
• Change in unrealized gains (losses) on available-for-sale securities:			
Unrealized gains arising during the year, net of income taxes(1)	7,170	14,201	19,885
Reclassification to net loss of realized gains, net of income taxes (2)	(24,064)	(11,361)	(13,312)
• Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations			
	34,489	(56,988)	54,610
• Gain (loss) on cash flow hedge			
	6,603	(8,845)	-
Other comprehensive income (loss)	24,198	(62,993)	61,183
Comprehensive income (loss)	\$ (266,089)	\$ (468,858)	\$ 42,657

(1) Net of income tax (recovery) of \$(7,403) in 2009, \$(3,827) in 2008.

(2) Net of income tax of \$3,530 in 2009, \$5,516 in 2008.

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of U.S. dollars)

Years ended December 31

	2009	2008	2007
Cash provided by (used in):			
Operating activities:			
Net loss	\$ (290,287)	\$ (405,865)	\$ (18,526)
Items not affecting cash:			
Loss (Income) on discontinued operations	183,947	263,098	(23,467)
Amortization of intangibles and goodwill impairment	10,650	60,468	7,167
Amortization of capital assets and deferred charges	3,208	4,358	4,899
Future and current income taxes	(30,410)	28,605	(4,233)
Net realized losses (gains)	(10,248)	11,202	(2,207)
Amortization of bond premiums and discounts	5,887	477	2,212
	(127,253)	(37,657)	(34,155)
Change in non-cash balances:			
Deferred policy acquisition costs	10,202	3,882	(15,111)
Due from reinsurers and other insurers	10,857	29,966	(62,769)
Unearned premiums	(42,454)	(49,927)	63,215
Unpaid claims	(6,298)	(16,097)	69,986
Increase in contributed surplus	10,758	2,172	2,267
Net change in other non-cash balances	(522,128)	(468,549)	169,542
	(666,316)	(536,210)	192,975
Financing activities:			
Increase (decrease) in share capital, net	-	89	1,082
Repurchase of common shares for cancellation	(27,053)	(5,172)	(8,129)
Common share dividend	(1,849)	(15,460)	(15,710)
Increase (decrease) in bank indebtedness and loans payable	32	29	(3,146)
Increase (decrease) in senior unsecured debentures	(8,439)	(34,877)	28,151
	(37,309)	(55,391)	2,248
Investing activities:			
Purchase of securities	(1,866,041)	(544,247)	(1,206,750)
Proceeds from sale of securities	2,459,160	984,215	1,060,409
Financed premiums receivable, net	1,296	(481)	(4,010)
Acquisitions	-	-	(44,721)
Net proceeds from sale of discontinued operations	43,858	44,067	-
Additions to capital assets	(2,005)	7,775	(16,127)
	636,268	491,329	(211,199)
Net change in cash and cash equivalents for discontinued operations	62,155	41,728	39,163
Increase (decrease) in cash position during the year	(5,202)	(58,544)	23,187
Cash and cash equivalents, beginning of year	63,928	122,472	99,285

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Cash and cash equivalents, end of year	\$	58,726	\$	63,928	\$	122,472
Supplementary disclosure of cash information:						
Represented by:						
Cash on hand and balances with banks		53,702		59,321		116,855
Investments with maturities less than 30 days		5,024		4,607		5,617
Cash and cash equivalents, end of year	\$	58,726	\$	63,928	\$	122,472
Cash paid for:						
Interest	\$	28,985	\$	36,581	\$	35,586
Income taxes		(21,262)		5,594		24,321
See accompanying notes to consolidated financial statements.						

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS

NOTE CHANGES IN ACCOUNTING POLICIES

1

NOTE SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2

NOTE FUTURE ACCOUNTING CHANGES - INTERNATIONAL FINANCIAL REPORTING
STANDARDS

3

NOTE DISCONTINUED OPERATIONS AND RELATED CONTINGENCIES

4

NOTE SECURITIES

5

NOTE FINANCIAL INSTRUMENTS

6

NOTE CAPITAL MANAGEMENT

7

NOTE HEDGES

8

NOTE CAPITAL ASSETS

9

NOTE SHARE CAPITAL

10

NOTE STOCK-BASED COMPENSATION

11

NOTE PENSION BENEFITS

12

NOTE UNDERWRITING POLICY AND REINSURANCE CEDED

13

NOTE INCOME TAXES

14

UNPAID CLAIMS

NOTE
15

NOTE SEGMENTED INFORMATION
16

NOTE INDEBTEDNESS
17

NOTE VARIABLE INTEREST ENTITIES
18

NOTE COMMITMENTS AND CONTINGENT LIABILITIES
19

NOTE GOODWILL AND INTANGIBLE ASSETS
20

NOTE RECONCILIATION OF CANADIAN AND UNITED STATES GENERALLY ACCEPTED
21 ACCOUNTING PRINCIPLES

NOTE CONTRACTUAL OBLIGATIONS
22

NOTE RELATED PARTY TRANSACTIONS
23

NOTE RESTRUCTURING CHARGES
24

NOTE COMPARATIVE FIGURES
25

NOTE SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION
26

NOTE SUBSEQUENT EVENTS
27

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

Kingsway Financial Services Inc. (the “Company”) was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. The Company is a financial services holding Company which, through its subsidiaries in Canada, the United States, Barbados and Bermuda, is engaged in property and casualty insurance.

NOTE 1 CHANGES IN ACCOUNTING POLICIES:

Commencing January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3064, Goodwill and Intangible Assets which replaced Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. The new standard establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. As a result of adopting the new standard, certain software costs previously recorded as Capital assets are now recorded as Intangible assets in the Consolidated Balance Sheet. Comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year. Accordingly, as at December 31, 2008, \$10.4 million was reclassified from Capital assets to Intangible assets. The related amortization expense that was previously recorded in General and administrative expenses on the Consolidated Statement of Operations is now recorded as Amortization of intangibles. Accordingly, \$5.5 million for the year ended December 31, 2008 was reclassified from General and administrative expenses to Amortization of intangibles.

Effective January 1, 2009, the Company adopted the CICA Emerging Issues Committee (“EIC”) Abstract No. 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities (“EIC-173”). EIC-173 clarifies the consideration of entity’s own credit risk and the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. There was no resulting difference noted on adoption.

In June 2009, the CICA issued amendments to CICA Handbook Section 3862, Financial Instruments - Disclosures. The amendments focused on improving disclosures about financial instruments. The amendments are effective for annual financial statements for fiscal years ending after September 30, 2009. The Company has adopted these amendments and has included these disclosures in Note 6.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition, and divestitures are included up to the date of disposal. Assets and liabilities of the acquired companies are included in the financial statements at their fair values at the date of acquisition. The Company holds interests in variable interest entities that are not included in the consolidated financial statements and which are more fully described in Note 18.

The following is a list of the material subsidiaries, all of which are 100% owned, directly or indirectly, with the jurisdiction of incorporation indicated in brackets: 7120 Hurontario Limited Partnership (Ontario); American Country Insurance Company (Illinois); American Country Underwriting Agency Inc. (Illinois); American Service Investment Corporation (Illinois); American Service Insurance Company, Inc. (Illinois); ARK Insurance Agency Inc. (Illinois); Appco Finance Corporation (Pennsylvania); Hamilton Risk Management Company (Florida); Insurance Management Services Inc. (Florida); Jevco Insurance Company (Quebec); KFS Capital LLC (Delaware); Kingsway 2007 General Partnership (Delaware); Kingsway America Inc. (Delaware); Kingsway America II Inc. (Delaware); Kingsway General Insurance Company (Ontario); Kingsway Nova Scotia Finance, ULC (Nova Scotia); Kingsway Reinsurance (Bermuda) Ltd. (Bermuda); Kingsway Reinsurance Corporation (Barbados); Mendota Insurance Company (Minnesota); Mendakota Insurance Company (Minnesota); Northeast Alliance Insurance Agency L.L.C. (formerly RPC Insurance Agency) (Delaware), Southern United Fire Insurance Company (Alabama); Southern United General Agency of Texas, Inc. (Texas); U.S. Security Insurance Company (Florida); and Universal Casualty Company (Illinois);

(b) Use of estimates:

The preparation of financial statements requires 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 revenues and expenses during the year. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

(c) Securities:

The Company has classified the securities held in its investment portfolio as available-for-sale (“AFS”) and held-to-maturity (“HTM”). During the year, the Company concluded that it had both the intent and ability to hold a portion of the Company’s fixed income investments to maturity and accordingly reclassified a portion of its investment portfolio to the HTM category. See Note 5 for further details. The HTM portfolio, which was established during 2009 in the Jevco Insurance Company (“Jevco”) securities portfolio, is included in “Assets held for sale” as at December 31, 2009.

AFS fixed income and equity investments are carried at their fair value, whereby the unrealized gains and losses are included in Accumulated Other Comprehensive Income (“AOCI”) until sale or until an other-than-temporary impairment is recognized, at which point cumulative unrealized gains or losses are transferred to the statement of operations. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect other-than-temporary impairments in value are included in “Net realized gains (losses)”. HTM investments are carried at amortized cost.

The Company accounted for the transfer of fixed income investments from the AFS to the HTM category at the estimated fair value of the investments at the date of transfer which represents their amortized cost as HTM investments. Any unrealized gains or losses, net of taxes, at the date of transfer continue to be reported as a component of accumulated other comprehensive income, and will be amortized over the remaining life of the investments through other comprehensive income. The original premium or discount will continue to be amortized on a constant yield basis to maturity as a component of investment income.

Dividends and interest income from these securities are included in “Net investment income”. Investment income is recorded as it accrues. Dividend income on common and preferred shares is recorded on the ex-dividend date.

The Company accounts for all financial instruments using trade date accounting.

Transaction costs are capitalized and, where applicable, amortized over the expected life of the instrument using the effective interest rate method.

The Company conducts a quarterly review to identify and evaluate securities (both debt and equity) that show objective indications of possible impairment. Impairment is charged to income if the fair value of a security falls below its cost/amortized cost, and the decline is considered other-than-temporary. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been below cost; financial condition and near-term prospects of the issuer; and the Company’s ability and intent to hold securities for a period of time sufficient to allow for any anticipated recovery.

(d) Cash and cash equivalents:

Cash and cash equivalents includes cash and securities with maturities of less than thirty days.

(e) Goodwill and intangible assets:

When the Company acquires a subsidiary or other business where it exerts significant influence, the fair value of the net tangible and intangible assets acquired is determined and compared to the amount paid for the subsidiary or business acquired. Any excess of the amount paid over the fair value of those net assets is considered to be goodwill.

Goodwill is tested at least annually for impairment to ensure that its fair value is greater than or equal to the carrying value. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined.

When the Company acquires a subsidiary or other business where it exerts significant influence or acquires certain assets, intangible assets may be acquired, which are recorded at their fair value at the time of the acquisition. An intangible asset with a definite useful life is amortized to income over its defined useful life. The Company writes down the value of an intangible asset with a definite useful life when the undiscounted cash flows are not expected to allow for full recovery of the carrying value.

Intangible assets with indefinite useful lives are not subject to amortization and are tested at least annually for impairment to ensure that fair values are greater than or equal to carrying values. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined.

(f) Deferred policy acquisition costs:

The Company defers brokers' commissions, premium taxes and other underwriting and marketing costs directly relating to the acquisition of premiums written to the extent they are considered recoverable. These costs are then expensed as the related premiums are earned. The method followed in determining the deferred policy acquisition costs limits the deferral to its realizable value by giving consideration to estimated future claims and expenses to be incurred as premiums are earned. Changes in estimates, if any, are recorded in the accounting period in which they are determined. Anticipated investment income is included in determining the realizable value of the deferred policy acquisition costs.

(g) Premium revenue and unearned premiums:

The Company earns premium revenue over the period covered by each individual insurance contract in proportion to the insurance protection provided. For motorcycle premiums, a higher percentage of the premiums are earned during the summer months, which constitute the motorcycle riding season in Canada. For all other lines of business, the premiums are earned evenly over the contract period. Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the year end.

The reinsurers' share of unearned premiums is recognized as amounts recoverable using principles consistent with the Company's method for determining the unearned premium liability.

A significant portion of the Company's revenue is subject to regulatory approvals. In Canada, automobile insurance premium rates other than for fleet automobiles are regulated by the provincial government authorities. In the United States, property and casualty insurance premium rates are subject to regulation by state government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates.

(h) Unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate for the full amount of all expected costs, including investigation, and the projected final settlements of claims incurred on or before the balance sheet date. The provision does not take into consideration the time value of money or make an explicit provision for adverse deviation.

These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in the light of emerging claims experience and changing circumstances. The resulting changes in estimates of the ultimate liability are recorded as incurred

claims in the accounting period in which they are determined.

(i) Reinsurance:

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers. Estimates of amounts recoverable from reinsurers on unpaid claims are recorded separately from estimated amounts payable to policyholders. Unearned premiums are also reported before reduction for business ceded to reinsurers and the reinsurers' portion is classified with amounts due from reinsurers.

Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the Company's method for determining the related policy liability associated with the reinsured policy.

(j) Translation of foreign currencies:

The consolidated financial statements have been presented in U.S. dollars as the Company's principal investments and cash flows are influenced primarily by the U.S. dollar. The operations of its subsidiaries in Canada, Bermuda and its head office operations are self sustaining. Assets and liabilities of non U.S. dollar denominated subsidiaries are translated at year end rates of exchange. Revenues and expenses of non U.S. dollar denominated subsidiaries are translated into U.S. dollars at the average monthly exchange rate. The net unrealized gains or losses which result from translation are deferred and included in shareholders' equity under the caption "Accumulated other comprehensive income". The currency translation adjustment will change with fluctuations in the Canadian to U.S. dollar exchange rate.

The unrealized foreign currency translation gains and losses arising from available-for-sale financial assets are included in other comprehensive income as unrealized gains/losses on available-for-sale securities until realized, at which time they are reclassified from accumulated other comprehensive income to the Consolidated Statement of Operations.

All amounts expressed in the financial statements are in U.S. dollars unless otherwise noted.

(k) Income taxes:

The Company follows the asset and liability method of accounting for income taxes, whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

(l) Stock-based compensation plan:

The Company has a stock-based compensation plan which is described in Note 11. The Company uses the fair-value method of accounting for stock-based compensation awards granted to employees and non-employee directors for options granted on or after January 1, 2003. The Company determines the fair value of the stock options on their grant date using the Black-Scholes option pricing model and records the fair value as a compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, the amount of proceeds together with the amount recorded in contributed surplus, is recorded in share capital.

No compensation expense is recognized for stock options granted prior to January 1, 2003. The consideration paid by employees and non-employee directors on exercise of these stock options is credited to share capital.

(m) Capital assets:

Capital assets are reported in the financial statements at amortized cost. Amortization of capital assets has been provided using the straight-line method over the estimated useful lives of such assets. The useful lives range from 10

to 40 years for buildings, 3 to 39 years for leasehold improvements, 3 to 10 years for furniture and equipment, 3 to 5 years for computer hardware and 3 to 5 years for automobiles.

NOTE 3 FUTURE ACCOUNTING CHANGES - INTERNATIONAL FINANCIAL REPORTING STANDARDS:

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that a profit-oriented publicly accountable enterprise will be required to adopt International Financial Reporting Standards (“IFRS”). IFRS will replace current Canadian general accepted accounting principles (“GAAP”) for those enterprises. For the Company, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. The Company has established a changeover plan in order to transition its financial statement reporting, presentation and disclosure under IFRS to meet the January 1, 2011 deadline.

The Company has undertaken the following Phases of the IFRS conversion process:

Phase 1, Initial Assessment:

- Prepared a project charter;
- Formed a steering committee;
- Established a project plan;
- Performed a high level impact assessment on the Company's financial statements.

Phase 2, Detailed Assessment:

- Identified the IFRS vs. Canadian GAAP gap analysis;
- Performed the accounting strategy analysis;
- Performed the information technology and internal controls impact assessments;
- Performed the business impact assessment;
- Designed employee training strategy;
- Elected the IFRS 1 First time adoption of IFRS optional exemptions.

Phase 3, Solutions Development:

- Selected IFRS accounting policies;
- Designed internal controls;
- Identified proposed system changes;
- Quantification of IFRS and Canadian GAAP differences;
- Preparation of proforma IFRS Financial Statements;
- Income Tax impact assessment;
- Renegotiation of contracts impacted by IFRS.

Phase 4, Implementation:

- Preparation of 2010 IFRS opening balance sheet and comparatives for each quarter of 2010;
- Implementation of IFRS accounting policies;
- Perform system enhancements to report under IFRS;
- Implement new accounting and business processes;
- Execute IFRS technical training and change to processes;
- Update accounting policy manual and guidelines.

Phase 1 and Phase 2 of the Conversion Project were completed in 2008 and 2009 respectively, and the Company has commenced Phase 3. The project is expected to be completed by December 31, 2010.

As accounting standards and interpretations continue to change prior to the transition, the Company has and will continue to adjust its IFRS conversion plan accordingly. The Company has been monitoring the development of standards as issued by the International Accounting Standards Board ("IASB") and the Canadian AcSB, as well as regulatory developments as issued by the Canadian Securities Administrators and the Office of the Superintendent of Financial Institutions ("OSFI").

NOTE 4 DISCONTINUED OPERATIONS AND RELATED CONTINGENCIES:

Walshire Assurance Company ("Walshire"), Zephyr Insurance Company, Inc. ("Zephyr") and Avalon Risk Management Inc. ("Avalon"), previously disclosed as part of the United States segment, and Jevco, Kingsway General Insurance Company ("KGIC") and York Fire and Casualty Insurance Company ("York Fire"), previously disclosed as part of the

Canadian segment, have been classified as discontinued operations and the results of their operations are reported separately for all periods presented.

Summarized financial information for discontinued operations is shown below.

Years ended December 31

	2009	2008	2007
Operations:			
Revenue	616,651	1,032,747	1,513,142
Income (loss) from discontinued operations before income taxes	(168,380)	(257,831)	24,815
Income taxes (recovery)	17,752	39,766	1,348
Income (loss) from discontinued operations before gain on disposal, net of taxes	(186,132)	(297,597)	23,467
Disposals:			
Gain on disposal before income taxes	1,860	41,411	-
Income taxes (recovery)	(325)	6,912	-
Gain on disposal, net of taxes	2,185	34,499	-
Income (loss) from discontinued operations, net of taxes	(183,947)	(263,098)	23,467

In the following table, the assets and liabilities at December 31, 2009 relate to Jevco, and the 2008 comparatives consist of Jevco and all other companies disposed in 2009.

As at December 31

	2009	2008
Assets		
Cash and cash equivalents	\$ 62,155	\$ 41,728
Securities	852,131	1,732,890
Accrued Investment Income	5,970	7,799
Finance Premiums	51,340	45,083
Accounts Receivable and other assets	19,930	143,283
Due from reinsurers and other insurers	76,293	162,150
Deferred policy acquisition costs	29,974	114,465
Income taxes recoverable	(5,295)	14,289
Future income taxes	2,802	9,451
Capital assets	48,885	71,430
Goodwill and intangible assets	1,296	5,996
Assets held for sale and of discontinued operations	\$ 1,145,481	\$ 2,348,564
Liabilities		
Accounts payable and accrued liabilities	\$ 9,759	\$ 54,098
Unearned premiums	144,323	373,369
Unpaid claims	753,334	1,504,217
Liabilities held for sale and of discontinued operations	\$ 907,416	\$ 1,931,684

Walshire:

In May 2009, the Company placed all of Lincoln General Insurance Company (“Lincoln”) into voluntary run-off. After that date Lincoln continued to experience losses from unfavourable reserve development. The result of Lincoln’s operational losses greatly reduced the Company’s capital flexibility and created the potential of the Company

breaching the covenants in its trust indentures. These ongoing losses also contributed to the financial strength rating downgrades of all operating companies.

On October 19, 2009, with the objective of protecting the interests of the Company's stakeholders, Kingsway America Inc. ("KAI"), an indirect wholly owned subsidiary of the Company, disposed of its entire interest in its wholly owned subsidiary, Walshire. Walshire is the sole shareholder of Lincoln. All of the stock of Walshire has been donated to charities, and with this disposition Lincoln ceases being a member of the Kingsway group of companies.

The Pennsylvania Insurance Department ("DOI") has challenged the disposition of Lincoln. On November 20, 2009, DOI filed a complaint in the Commonwealth Court of Pennsylvania ("Commonwealth Court") against the Company, KAI and Walshire, seeking a declaration that the disposition was unlawful and not valid. The Company disagrees with the DOI's position and maintains that the donations of Walshire shares to the charities were lawful and valid. On November 19, 2009, the day before the DOI's complaint, the Company and KAI filed a complaint in the Commonwealth Court against the DOI seeking a declaration that the statute upon which the DOI principally relies did not apply to the donations. In response to the Company's complaint, the DOI filed a New Matter (in essence, a Counterclaim). The Company has demurred to each of the claims in the DOI's complaint, thereby putting the legal sufficiency of the DOI's claims at issue. The analogous procedure, in Ontario, would be a motion to strike out a pleading for failure to disclose a cause of action. The demurrers were argued to a panel of the Commonwealth Court on February 9, 2010, which has reserved its decision. The timing of the decision is at the discretion of the Commonwealth Court.

If the demurrers are unsuccessful, the complaints would proceed through the courts in due course. If the ultimate decision of the courts is unfavorable for the Company, the control of Lincoln may revert back to the Company, which would result in Lincoln's financial results being included in the Company's consolidated financial statements. If the Commonwealth Court or a higher court deems the transaction to be invalid, it could ultimately lead to the Company being in breach of its public debt covenants should Lincoln go into liquidation while still part of the Company. The Company's public debt is material, and a breach in covenants could lead to the liquidation of the Company if principal and interest payments are called before maturity.

The Company's commitment to the DOI to provide a \$10.0 million cash payment to Lincoln was paid in the fourth quarter. The Company also maintains an obligation to provide certain continued administrative support to the run-off management team at Lincoln and human resources services previously provided to Lincoln by the Company have been terminated. The Company also has continuing obligations on reinsurance agreements with Lincoln which are at market terms and conditions. These ongoing obligations are not significant and do not provide the Company with any control or significant influence over the operating activities or financial results of Lincoln.

On June 29, 2009, Kingsway and Lincoln entered into a consulting agreement with an external run-off manager to provide certain consulting services relating to Lincoln, including advice and assistance in the development of a Run-off Plan. In addition to base compensation of \$1.3 million annually, the agreement provides for a minimum of \$2.5 million to be paid to the run-off manager at the termination of the contract (provided the contract is not terminated for cause), which, at the latest will be March 1, 2014. As a result of the October 19, 2009 disposition of Walshire and Lincoln, the Company has accrued \$2.5 million for the minimum and an additional \$3.4 million relating to the annual service contract for a total compensation of \$5.9 million as at December 31, 2009. In addition, the Company has guaranteed the portion of the management fees payable by Lincoln to the run-off manager. See Note 19(d) for additional details.

At September 30, 2009, the total investment in Walshire was written down to nil. After taking into account the operating loss of Lincoln from October 1 to 19, 2009, factoring in realized investment gains and the write down of net assets, a net gain on disposal of \$1.4 million was recorded and included in discontinued operations. The results of Lincoln from January 1 to October 19, 2009, the aggregate of the write-down of the investment in Walshire and the

\$10.0 million cash payment have been included in the income (loss) from discontinued operations, net of taxes line item in the Company's consolidated statement of operations for the year ended December 31, 2009.

The company's revenues from discontinued operations relating to Walshire were \$226.1 million, \$521.3 million and \$868.1 million in 2009, 2008 and 2007 respectively. In total, the Company's loss from discontinued operations relating to Walshire, net of taxes was \$156.9 million, \$259.1 million and \$85.4 million in 2009, 2008 and 2007 respectively.

At the date of disposition, the securities, other non-cash assets and total liabilities of Walshire were \$649.1 million, \$322.7 million and \$889.3 million respectively.

Zephyr:

On October 30, 2009, the company completed its previously announced sale of Zephyr, a specialty property insurance company founded specifically to protect Hawaii homeowners and residents from catastrophic loss due to hurricanes, for \$31.5 million plus a settlement of pre-closing earnings and other post closing adjustments of \$5.5 million.

As a result of the disposal, the Company recognized an after tax gain of \$2.9 million during 2009. The company's revenues from discontinued operations relating to Zephyr were \$14.1 million, \$14.6 million and \$10.1 million in 2009, 2008 and 2007 respectively. In total, the Company's income (loss) from discontinued operations including the gain on disposal, net of taxes were \$11.6 million, \$(0.2) million and \$4.9 million in 2009, 2008 and 2007 respectively.

Avalon:

On October 9, 2009, specific assets of Avalon Risk Management Inc. were sold for \$1.5 million pursuant to an Asset Purchase agreement with FMG Specialty Insurance Agency LLC. The agreement also included a transition services agreement.

As a result of the disposal, the Company recognized an after tax gain of \$1.0 million during 2009. As described in Note 20(b), the Company wrote down the remaining associated intangible assets of \$1.6 million. The company's revenues from discontinued operations relating to Avalon were \$5.4 million, \$15.1 million and \$11.6 million in 2009, 2008 and 2007 respectively. In total, the Company's loss from discontinued operations relating to Avalon, net of taxes were \$6.7 million, \$1.9 million and \$1.6 million in 2009, 2008 and 2007 respectively.

Canadian Operations:

As a result of the Company's ongoing strategic initiatives (Note 24), on October 1, 2009, Jevco assumed the assets and liabilities of KGIC, a wholly owned Canadian subsidiary of the Company.

On November 20, 2009, the Company was advised by A. M. Best Company ("A. M. Best") that the financial strength rating for Jevco was downgraded from "B" to "B-". On November 23, 2009, as a result of A.M. Best's downgrade of Jevco's financial strength rating, the company undertook to dispose of its majority interest in Jevco.

On January 25, 2010, the Company entered into a definitive purchase agreement with The Westaim Corporation ("Westaim") to sell all of the issued and outstanding shares of Jevco to Westaim. On March 29, 2010, after receipt of all required regulatory approvals, the sale was completed for a purchase price of C\$264.2 million. This was based on 94.5% of the difference between the book value of Jevco as at December 31, 2009 and a dividend of C\$10.8 million, an investment portfolio adjustment relating to the change in market value at the closing date and is subject to certain future contingent adjustments. The contingent adjustments include up to C\$20.0 million decrease in the purchase price relating to specific future adverse claims development to be determined at the end of 2012. The Company also has the option to sell a property that was included in the purchase agreement. The purchase price will decrease if the sale price of the property is less than its carrying value, up to a maximum of approximately C\$6.3 million. The purchase price will increase by 94.5% of every dollar that the sale price exceeds the carrying value. The Company currently has an offer from a third party to purchase the property, for approximately its carrying value.

In connection with the sale of Jevco, the Company recorded a write-down of \$26.6 million, which represents the difference between the net book value of Jevco and the purchase price less selling costs and excluding any contingent adjustments not determinable until a future date.

In addition, since the purchase price of Jevco was less than its net book value, it was determined that the goodwill relating to the Canadian operating segment was fully impaired. As a result, the Company recorded in operating income a non-cash goodwill impairment charge relating to the Canadian operations of \$6.9 million.

Due to covenant restrictions associated with the sale of restricted subsidiaries under the Kingsway America Inc., 7.50% senior notes and the Kingsway 2007 General Partnership, 6.00% senior unsecured debentures, the Company was required to lower its applicable ratios to a level where the restrictions would no longer apply. Subsequent to December 31, 2009, the company entered into a series of contingent trades which were completed on March 30, 2010, whereby the Company repurchased \$84.8 million of par value of the senior unsecured debentures. The repurchase resulted in a gain of \$15.7 million, which will be recorded in the first quarter 2010 results. See Note 27(b) for additional details.

The Company's revenues from discontinued operations relating to the Canadian Operations were \$371.3 million, \$401.3 million and \$489.9 million in 2009, 2008 and 2007 respectively. In total, the Company's income (loss) from discontinued operations relating to the Canadian Operations, net of taxes were \$(28.1) million, \$(25.4) million and \$93.3 million in 2009, 2008 and 2007 respectively.

At December 31, 2009, the securities, other non-cash assets and total liabilities of Jevco being held for sale were \$852.1 million, \$231.3 million and \$ 907.4 million respectively.

York Fire:

On September 30, 2008, the Company sold York Fire, a primarily standard insurance writer, to La Capitale General Insurance Inc. for C\$95 million in cash. The final settlement was completed in the first quarter of 2009 and the adjustments were reflected accordingly. The Company's revenues from discontinued operations relating to York Fire were \$(0.2) million, \$80.4 million and \$133.4 million in 2009, 2008 and 2007 respectively. In total, the Company's gain from discontinued operations relating to York Fire, net of taxes were \$(3.8) million and \$23.4 million and \$12.3 million in 2009, 2008 and 2007 respectively.

NOTE 5 SECURITIES:

The amortized cost and fair values of investments are summarized below:

	December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Term deposits	\$ 23,791	\$ -	\$ -	\$ 23,791
Bonds:				
Canadian - Government	208	7	-	215
U.S. - Government	265,117	4,240	551	268,806
- Corporate	186,502	4,135	1,094	189,543
- Commercial Mortgage backed	14,141	-	189	13,952
- Other asset backed	7,573	185	66	7,692
Sub-total	\$ 497,332	\$ 8,567	\$ 1,900	\$ 503,999
Preferred shares				
- Canadian	9,014	-	893	8,121
- U.S.	92	-	15	77
	\$ 506,438	\$ 8,567	\$ 2,808	\$ 512,197

					December 31, 2008			
		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value			
Term deposits		\$ 184,437	\$ 771	\$ 20	\$ 185,188			
Bonds:								
Canadian	- Government	149,200	8,310	7	157,503			
	- Corporate	178,270	1,881	7,562	172,589			
	- Commercial Mortgage backed	66,185	455	4,731	61,909			
	- Other asset backed	13,304	78	127	13,255			
U.S.	- Government	542,850	43,159	177	585,832			
	- Corporate	758,940	13,593	22,981	749,552			
	- Commercial Mortgage backed	25,434	495	2,977	22,952			
	- Residential Mortgage backed	1,500	-	868	632			
	- Other asset backed	19,139	8	1,399	17,748			
Other	- Corporate	128,382	4,328	999	131,711			
Sub-total		\$ 2,067,641	\$ 73,078	\$ 41,848	\$ 2,098,871			
Common shares	- Canadian	114,168	2,590	-	116,758			
	- U.S.	146,406	4,883	-	151,289			
Preferred shares	- Canadian	6,692	8	3,629	3,071			
	- U.S.	635	-	139	496			
		\$ 2,335,542	\$ 80,559	\$ 45,616	\$ 2,370,485			
Less Discontinued Operations and Assets held for sale					(1,732,890)			
Total excluding discontinued operations and assets held for sale					\$ 637,595			

The following tables highlight the aggregate unrealized loss position, by security type, of holdings in an unrealized loss position as at December 31, 2009 and 2008. The tables segregate the holdings based on the period of time the securities have been continuously held in an unrealized loss position.

					December 31, 2009				
		0 - 12 Months		Over 12 Months					
		Fair Value	Unrealized Loss	Fair Value	Unrealized Loss				
Bonds:									
U.S.	- Government	\$ 161,535	\$ (551)	\$ -	\$ -				
	- Corporate	91,989	(956)	1,878	(138)				
	- Commercial Mortgage backed	13,952	(189)	-	-				
	- Other asset backed	1,805	(11)	996	(55)				
Sub-total		\$ 269,281	\$ (1,707)	\$ 2,874	\$ (193)				
Preferred shares	- Canadian	8,121	(893)	-	-				
	- U.S.	-	-	77	(15)				
		\$ 277,402	\$ (2,600)	\$ 2,951	\$ (208)				

	0 - 12 Months		December 31, 2008	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Term deposits	\$ 18,856	\$ (20)	\$ -	\$ -
Bonds:				
Canadian - Government	2,482	(7)	-	-
- Corporate	63,037	(5,392)	30,564	(2,170)
- Commercial Mortgage backed	17,493	(1,023)	31,397	(3,708)
- Other asset backed	3,278	(29)	3,472	(98)
U.S. - Government	9,280	(177)	79	-
- Corporate	253,473	(14,940)	97,517	(8,041)
- Commercial mortgage backed	7,292	(1,638)	4,441	(1,339)
- Residential mortgage backed	-	-	632	(868)
- Other asset backed	13,682	(780)	3,050	(619)
Other - Corporate	6,382	(112)	3,321	(887)
Sub-total	\$ 395,255	\$ (24,118)	\$ 174,473	\$ (17,730)
Preferred shares - Canadian	-	-	3,073	(3,629)
- U.S.	102	(2)	395	(137)
	\$ 395,357	\$ (24,120)	\$ 177,941	\$ (21,496)

Note: 2008 analysis includes both continuing and discontinuing operations

Fair values of term deposits, bonds and common and preferred shares are considered to approximate quoted market values based on the latest bid prices in active markets. Fair values of securities for which no active market exists are derived from quoted market prices of similar securities or other third party evidence.

Management performs a quarterly analysis of the Company's investment holdings to determine if declines in market value are other than temporary. The analysis includes some or all of the following procedures as deemed appropriate by management:

- identifying all security holdings in unrealized loss positions that have existed for at least six months or other circumstances that management believes may impact the recoverability of the security;
- obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;
- reviewing the trading range of certain securities over the preceding calendar period;
- assessing if declines in market value are other than temporary for debt security holdings based on their investment grade credit ratings from third party security rating agencies;
- assessing if declines in market value are other than temporary for any debt security holding with non-investment grade credit rating based on the continuity of its debt service record;

- determining the necessary provision for declines in market value that are considered other than temporary based on the analyses performed; and
- assessing the Company's ability and intent to hold these securities at least until the investment impairment is recovered.

The risks and uncertainties inherent in the assessment methodology utilized to determine declines in market value that are other than temporary include, but may not be limited to, the following:

- the opinion of professional investment managers could be incorrect;
- the past trading patterns of individual securities may not reflect future valuation trends;
- the credit ratings assigned by independent credit rating agencies may be incorrect due to unforeseen or unknown facts related to a Company's financial situation; and
- the debt service pattern of non-investment grade securities may not reflect future debt service capabilities and may not reflect the Company's unknown underlying financial problems.

As a result of the above analysis performed by management to determine declines in market value that are other than temporary, write-downs for other than temporary impairments relating to continuing operations were \$0.7 million (2008 - \$12.7 million) during the year. These impairment charges included \$nil (2008 - \$8.5 million) from the write down of common stocks and \$0.7 million (2008 - \$4.2) from the write-down of debt securities.

Management has reviewed currently available information regarding other securities whose estimated fair values are less than their carrying amounts and believes that these unrealized losses are not other than temporary and are primarily due to temporary market and sector related factors rather than to issuer-specific factors. Debt securities whose carrying amounts exceed fair value can be held until maturity when management expects to receive the principal amount.

Net investment income for the years ended December 31 is comprised as follows:

	2009	2008	2007
Investment income:			
Interest	\$ 19,289	\$ 36,040	\$ 43,708
Dividends	516	1,043	977
Premium financing	(683)	(513)	(1,435)
Other	(14,833)	1,281	2,121
Gross investment income	4,289	37,851	45,371
Investment expenses	1,561	2,540	3,128
Net investment income	\$ 2,728	\$ 35,311	\$ 42,243

The decrease in interest income in 2009 compared to 2008 is primarily due to the impact on yields from a reduction in short term interest rates and from the duration and risk profile of the portfolio having been reduced during the year. Also contributing to the reduction in interest income is a reduction in the size of the securities portfolio as a result of reduced volumes of business in the Company's continuing operations, the acceleration of claim payments and debt and equity buybacks and other corporate initiatives. The decrease in investment income in 2008 compared to 2007 is primarily due to lower short term yields and a reduction in the size of the portfolio as a result of the repayment of the Company's bank debt.

The significant reduction in dividend income in 2009 compared to 2008 is primarily a result of the decision by the Company to divest of substantially all of the common equities in the securities portfolio. The dividend income in 2009 represents the dividend income earned on the common equity portfolio prior to the divestitures described above, as well as dividend income earned on the remaining preferred share portfolio.

Other investment income in 2009 includes a net loss of approximately \$17.0 million due to the impact of the strengthening of the Canadian dollar on U.S. dollar assets in the Canadian head office and net Canadian dollar liabilities in the U.S. operations. Offsetting this impact, on the statement of operations the stronger Canadian dollar increased the book value of our Canadian operations in U.S. dollar terms and this increase in book value is reflected in other comprehensive income in the Company's consolidated financial statements.

The reduction in investment expenses reflect the lower investment management fees paid as a result of a smaller, exclusively fixed income securities portfolio.

Net realized gains and (losses) for the years ended December 31 are comprised as follows:

	2009	2008	2007
Fixed income	\$ 12,276	\$ (1,795)	\$ (819)
Equities	(1,339)	3,282	3,279
Other than temporary impairment	(689)	(12,689)	(253)
Net realized gains and (losses)	\$ 10,248	\$ (11,202)	\$ 2,207

The Company incurred net realized gains in 2009 of \$10.2 million compared to net realized losses of \$11.2 million in 2008. The net gain in 2009 is due to gains realized from the liquidation of fixed income securities in the Company's captive reinsurance company in Barbados to facilitate the related party reinsurance commutation transactions, partially offset by realized losses on the disposal of the Company's common equity portfolio and impairments for other than temporarily impaired securities. The net loss in 2008 is primarily due to the challenging fixed income and equity markets which began in late 2007 and includes the write-down of all of the unrealized losses on the common share equity portfolio as a result of the Company's decision to divest of this portfolio in early 2009.

NOTE 6 FINANCIAL INSTRUMENTS:

(a) Financial risk management objectives and policies:

By virtue of the nature of the Company's business activities, financial instruments make up the majority of the balance sheet. The risks which arise from transacting financial instruments include credit risk, market risk, liquidity risk and cash flow risk. These risks may be caused by factors specific to an individual instrument or factors affecting all instruments traded in the market. The Company has a risk management framework in place to monitor, evaluate and manage the risks assumed in conducting its business. The Company manages these risks using risk management policies and practices.

Further details are provided below on the risk management objectives and policies as they relate to the specific financial risks:

Credit risk:

The Company is exposed to credit risk principally through its fixed income securities and balances receivable from policyholders and reinsurers. The Company monitors concentration and credit quality risk through policies to limit and monitor its exposure to individual issuers or related groups (with the exception of U.S. and Canadian government bonds) as well as through ongoing review of the credit ratings of issuers held in the securities portfolio. The Company's credit exposure to any one individual policyholder is not material. The Company's policies, however, are distributed by agents, program managers or brokers who manage cash collection on its behalf. The Company has policies to evaluate the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvency.

The table below summarizes the credit exposure of the Company from its investments in fixed income securities and term deposits by rating as assigned by Standard & Poor's ("S&P") or Moody's Investor Services, using the higher of these ratings for any security where there is a split rating:

2009	2008
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AAA/Aaa	\$314,780	62.4%	\$1,146,703	54.7%
AA/Aa	71,587	14.2	341,280	16.3
A/A	106,174	21.1	505,748	24.1
BBB/Baa	8,936	1.8	65,255	3.1
BB/Ba	-	-	5,122	0.2
B/B	-	-	7,838	0.4
CCC/Caa or lower, or not rated	2,522	0.5	26,925	1.2
Total	\$503,999	100.0%	\$2,098,871	100.0%

Note: 2008 analysis includes both continuing and discontinued operations

Market risk:

The market risk exposure of the Company consists mainly of changes in interest rates and equity prices and to a smaller extent, to foreign currency exchange rates. Market risk is subject to risk management. The Investment Committee of the Board and senior management of the Company monitor the Company's market risk exposures and activities that give rise to these exposures.

Interest rate risk:

The Company is exposed to changes in the value of its fixed income securities to the extent that market interest rates change. The Company actively manages its interest rate exposure with the objective of enhancing net interest income within established risk tolerances and Board approved investment policies. Because most of the securities portfolio is comprised of fixed income securities that are usually held to maturity, periodic changes in interest rate levels generally impact the financial results to the extent that reinvestment yields are different than the original yields on maturing securities. Also, during periods of rising interest rates, the market value of the existing fixed income securities will generally decrease and realized gains on fixed income securities will likely be reduced. The reverse is true during periods of declining interest rates.

It is estimated that an immediate hypothetical 100 basis point increase in interest rates would decrease the market value of the fixed income securities by \$15.7 million, representing 3.1% of the \$512.1 million fair value fixed income securities portfolio. Since the continuing operations securities portfolio is classified as available-for-sale, the impact of this hypothetical increase in interest rates would affect other comprehensive income and have no effect on net income until the security is sold or written down as a result of other than temporary impairment.

Computation of the prospective effect of hypothetical interest rate changes are based on numerous assumptions, including maintenance of the existing levels and composition of fixed income security assets at the indicated date and should not be relied on as indicative of future results. The analysis is done on the following assumptions:

- (a) the securities in the Company's portfolio are not impaired;
- (b) credit and liquidity risks have not been considered;
- (c) interest rates and equity prices move independently; and
- (d) shifts in the yield curve are parallel.

Available-for-sale securities in an unrealized loss position as reflected in Accumulated Other Comprehensive Income, may at some point in the future be realized through a sale or impairment.

Equity price risk:

The Company is exposed to changes in the value of equity securities as a result of market conditions. This is the risk of loss due to adverse movements in equity prices.

In early 2009, the Company elected to significantly reduce this equity risk by liquidating virtually all of the common equity portfolio. As a result, the Company's exposure to equity price risk is considered to be low.

Foreign currency risk:

The Company is exposed to changes in the U.S. to Canadian dollar foreign currency exchange rate, primarily through Canadian dollar indebtedness. It does not hedge any of this foreign currency exposure. Its U.S. operations generally hold their investments in U.S. dollar denominated securities, and the Canadian operations in Canadian dollar denominated securities. A one cent appreciation in the value of the Canadian dollar relative to the U.S. dollar decreases net income before income taxes by approximately \$1.4 million.

Liquidity and cash flow risk:

Liquidity risk is the risk of having insufficient cash resources to meet current financial obligations without raising funds at unfavorable rates or selling assets on a forced basis. Liquidity risk arises from general business activities and in the course of managing the assets and liabilities. There is the risk of loss to the extent that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows. Cash flow risk arises from risk that future inflation of policyholder cash flow exceeds returns on long-dated investment securities. The purpose of liquidity and cash flow management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. The liquidity and cash flow requirements of the Company's business have been met primarily by funds generated from operations, asset maturities and income and other returns received on securities as well as the sale of certain operations. Cash provided from these sources is used primarily for claims and claim adjustment expense payments and operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements. To meet these cash requirements, the Company has policies to limit and monitor its exposure to individual issuers or related groups and to ensure that assets and liabilities are broadly matched in terms of their duration and currency. The Company believes that it has the flexibility to obtain, from internal sources and the sale of Jevco, (Note 27), the funds needed to fulfill the cash requirements during the current financial year and also to satisfy regulatory capital requirements.

The Company holds \$82.5 million in cash and high grade short-term assets, representing approximately 14% of invested assets. The majority of the other fixed income securities are also liquid.

The following table summarizes carrying amounts of financial instruments from continuing operations by contractual maturity or expected cash flow dates. Since only assets from continuing operations are disclosed in the table, the \$C264.2 million proceeds from the sale of Jevco subsequent to year end are not reflected. Subsequent to year end, \$69.1 million from the proceeds of the sale of Jevco were used to repurchase a total par value of \$36.9 million of senior unsecured indebtedness maturing in 2012 and \$47.9 million of the senior unsecured indebtedness maturing in 2014. The Company may seek to repurchase additional indebtedness in the future, depending upon market conditions and capital requirements within the group. For this reason, as well as the fact that certain securities and debentures have the right to call or prepay obligations, the actual settlement dates may differ from contractual maturity.

As at December 31	One year or less	One to five years	Five to ten years	More than ten years	No Specific date	Total
Assets:						
Cash and cash equivalents	\$ 58,726	\$ -	\$ -	\$ -	\$ -	\$ 58,726
Securities	68,138	293,868	94,675	55,439	77	512,197
Accrued investment income	4,158	-	-	-	-	4,158
Finance premiums	15,237	-	-	-	-	15,237
Accounts receivable and other assets	94,285	-	-	-	-	94,285
Due from reinsurers and other insurers	2,387	2,260	280	11	-	4,938
Total:	242,931	296,128	94,955	55,450	77	689,541
Liabilities:						
Loans payable	-	-	66,222	-	-	66,222
Accounts payable and accrued liabilities	61,041	-	-	-	-	61,041
Unpaid claims	181,302	165,836	20,553	810	-	368,501
Senior unsecured debentures	-	176,764	-	-	-	176,764
Subordinated indebtedness	-	-	-	87,415	-	87,415
Total:	242,343	342,600	86,775	88,225	-	759,943

The coupon rates for the fixed term securities range from 0.7% to 9.5% at December 31, 2009. The average effective yield (using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts) is 2.92%.

(b) Fair value:

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act.

Fair value is best evidenced by quoted bid or ask price, as appropriate, in an active market. Where bid or ask prices are not available, such as in an illiquid or inactive market, the closing price of the most recent transaction of that instrument subject to appropriate adjustments as required is used. Where quoted market prices are not available, the quoted prices of similar financial instruments or valuation models with observable market based inputs are used to estimate the fair value. These valuation models may use multiple observable market inputs, including observable interest rates, foreign exchange rates, index levels, credit spreads, equity prices, counterparty credit quality, corresponding market volatility levels and option volatilities. Minimal management judgment is required for fair values calculated using quoted market prices or observable market inputs for models. The calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values. For the Company's financial instruments carried at cost or amortized cost, the book value is not adjusted to reflect increases or decreases in fair value due to market fluctuations, including those due to interest rate changes as it is the company's intention to hold them until there is a recovery of fair value, which may be to maturity.

The Company records the AFS securities held in its securities portfolio at their fair value. The Company primarily uses the services of external securities pricing vendors to obtain these values. The securities are valued using quoted market prices or prices established using observable market inputs. In the current volatile market conditions, these quoted market prices or observable market inputs can change rapidly causing a significant impact on fair value and financial results recorded.

Refer to Note 5 with respect to fair value disclosure on securities.

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of quoted market prices (Level 1), internal models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of securities as at December 31, 2009 was as follows:

As at December 31, 2009

Description	Available for sale securities	
	Equity	Fixed income
Fair value	\$8,198	\$503,999
Based on:		
Quoted market prices (level 1)	100.0 %	-
Valuation techniques -Significant market observable Inputs (level 2)	-	100.0 %
Valuation techniques - Significant unobservable market inputs (level 3)	-	-

The table below summarizes the fair valuation of debt liabilities, though they are held at amortized cost on the consolidated balance sheet:

As at December 31	Total Fair Value*	Total Carrying Value	2009 Favourable/ (Unfavourable)
Loans payable	\$24,187	\$66,222	\$ 42,035

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Senior unsecured debentures	103,512	176,764	73,252
Subordinated indebtedness	\$22,788	\$87,415	\$ 64,627

As at December 31	Total Fair Value*	Total Carrying Value	2008 Favourable/ (Unfavourable)
Loans payable	\$43,094	\$66,222	\$ 23,128
Senior unsecured debentures	128,497	185,203	56,706
Subordinated indebtedness	\$17,712	\$87,383	\$ 69,671

* The fair value is based on market observable inputs.

The fair value of debt is currently considerably below the carrying value reflecting the credit risk to holders of the Company's securities.

The carrying value of unpaid claims does not take into consideration the time value of money or make an explicit provision for adverse deviation. In order to estimate the fair value of the unpaid claims, the Company uses an actuarial approach recognizing the time value of money which incorporates assumptions concerning projected cash flows and appropriate provisions for adverse deviation. As at December 31, 2009, the estimated fair value of unpaid claims was \$387.3 million (\$386.0 million net of reinsurers' share of unpaid claims). The estimated fair value is approximately \$18.8 million above the undiscounted carrying value as a result of the inclusion of a provision for adverse development totaling \$34.8 million in addition to the present value of unpaid claims. There is no active market for policy liabilities; hence market value is not determinable.

The carrying value of all other financial instruments approximates their fair value due to the short term to maturity of those financial instruments.

NOTE 7 CAPITAL MANAGEMENT:

Objectives, policies and procedures:

The Company has three capital management objectives: to meet regulatory requirements, to develop strong financial strength ratings and to maximize returns to shareholders. It manages capital in accordance with policies established by the Board. These policies relate to capital strength, capital mix, dividends and return on capital, and the unconsolidated capital adequacy of all regulated entities. The Company has a capital management process in place to measure, deploy and monitor its available capital and assess its adequacy on a continuous basis. Senior executive management develops the capital strategy and oversees the capital management processes of the Company. Capital is managed using both regulatory capital measures and internal metrics. The Company's capital is primarily derived from common shareholders' equity, retained earnings and accumulated other comprehensive income.

As a holding company, the Company derives cash from its subsidiaries generally in the form of dividends and management fees to meet its obligations, which primarily consist of dividend and interest payments. The Company's insurance subsidiaries fund their obligations primarily through the premium and investment income and maturities in the securities portfolio. The operating insurance subsidiaries require regulatory approval for the return of capital and, in certain circumstances, prior to the payment of dividends. In the event that dividends and management fees available to the holding company are inadequate to service its obligations, the Company would need to raise capital, sell assets or restructure its debt obligations.

The Company's dividend was suspended in the second quarter of 2009.

Throughout 2009 the Company has continued to experience losses. The reduction in shareholders' equity as a result of these ongoing losses greatly reduced the Company's capital flexibility by triggering negative covenants in its trust indentures and limiting the dividend capacity of the operating subsidiaries. A description of the negative covenants is disclosed below. For further details on the capital adequacy of the operating subsidiaries, see the 'Regulatory capital requirements and ratios' section of this note to the financial statements.

Certain debentures issued by the Company contain negative covenants in their trust indentures, placing limitations and restrictions over certain actions without the prior written consent of the indenture trustees. Included in the negative covenants is the limitation on the incurrence of additional debt in the event that the total debt to total capital ratio or the senior debt to total capital ratio exceed 50% and 35%, respectively. The total debt is calculated on a pro-forma basis taking into account the issuance of additional debt. The debentures also include covenants limiting the issuance and sale of voting stock of restricted subsidiaries, the payment of dividends or any other payment in respect of capital

stock of the Company, or the retirement of debt subordinate to the debentures covered by the trust indentures if, after giving effect to such payments as described in the trust indentures, the total debt to total capital ratio exceeds 50%. In this calculation, total debt and senior debt are determined on a current basis and total capital is determined based on the most recent publicly filed financial statements.

Based on the December 31, 2009 financial statements the Company's total debt to capital and senior debt to capital ratios were 66.6% and 48.7% respectively. As a result, the limitations and restrictions described above are applicable. When reviewing applicable activities, compliance is based on a calculation of the last reported equity balance and the debt level at the point of time of the transaction.

Early in 2010 the Company announced that it had entered into a definitive agreement for the sale of Jevco. On March 29, 2010, the sale of Jevco was completed. Although Jevco is a restricted subsidiary, prohibiting the sale of its voting stock under the terms of the restrictive covenants described above, a portion of the proceeds from this transaction was used to repay outstanding indebtedness sufficient to lower the ratios applicable to the restrictive covenants to a level where the restrictions no longer apply following the application of the proceeds in this manner. Following the release of the Company's year-end results the debt to capital ratios described above exceed the thresholds and as a result these restrictions are applicable from March 31, 2010.

Debt and Equity Buyback Initiative:

In May 2009 the Board of Directors delegated to the Capital Committee of the Board of Directors the authority to repurchase debt of the Company up to a maximum of \$40.0 million.

On June 26, 2009, KFS Capital LLC, an indirect wholly-owned subsidiary of the Company, commenced a take-over bid (the "KLROC Offer") to acquire up to 1,000,000 preferred, retractable, redeemable, cumulative units of Kingsway Linked Return of Capital Trust at a price per unit of C\$12.00 in cash. The KLROC Offer expired on Tuesday, August 4, 2009 and 694,015 units were tendered. This tender was paid for using available cash.

Kingsway 2007 General Partnership, an indirect wholly-owned subsidiary of the Company, announced on July 14, 2009 the commencement of a modified "Dutch Auction" tender offer (the "2012 Offer") for a portion of its outstanding Unsecured 6% Debentures due July 11, 2012 (the "2012 Debentures"). The 2012 Offer provided for a cash purchase of 2012 Debentures at a price per C\$1,000 principal amount of debentures of not less than C\$540 and not greater than C\$620, for a maximum aggregate purchase price to the offer or not to exceed C\$31 million (excluding accrued and unpaid interest). The 2012 Offer expired Friday, August 14, 2009 with valid tenders (that were not withdrawn) of C\$9,174,000 in aggregate principal amount of Debentures. Kingsway 2007 General Partnership accepted for purchase all such tendered Debentures at the highest price specified of C\$620 per C\$1,000 principal amount. This tender was paid for using available cash.

The Company continues to explore opportunities to buy back debt in the market in order to reduce the debt to capital ratios below the level at which these operating restrictions apply, while ensuring that the debt covenants are fully complied with. The Company's public debt is material and a breach in covenants could lead to the liquidation of the Company if principal and interest payments are called before maturity.

In November 2009, the Company repaid in full a \$6.9 million mortgage on a property.

The Capital Committee of the Company's Board of Directors has recommended that capital allocated for the buyback initiative that remained unused following the expiry of: (i) the modified "Dutch Auction" tender offer for a portion of its outstanding Unsecured 6% Debentures due July 11, 2012, and (ii) the expiry of the take-over bid for units of the Kingsway Linked Return of Capital Trust, be applied to the repurchase of Kingsway common shares pursuant to the Company's normal course issuer bid.

The Company announced on July 29, 2009 an amendment to its normal course issuer bid for common shares had been approved by the Toronto Stock Exchange ("TSX"). The normal course issuer bid was originally announced by the Company on November 28, 2008. Purchases under the normal course issuer bid from December 2, 2008 to December 1, 2009 were limited to 2,753,426 common shares (or approximately 5% of the aggregate number of common shares outstanding on November 15, 2008). Purchases under the normal course issuer bid, as amended, are now limited to 5,386,545 common shares, or 10% of the public float on November 28, 2008. Purchases under this amended normal course issuer bid expired on December 1, 2009. During 2009, 3,472,700 shares have been repurchased under the

current normal course issuer bid at an average price of C\$3.77.

As at December 31, 2009, the Company had 51,595,828 common shares outstanding compared with 55,068,528 common shares outstanding at December 31, 2008.

As at December 31, 2009, of the \$40.0 million authorized by the Board of Directors to repurchase debt and equity of the Company, approximately \$33.7 million had been used. This repurchase program is no longer active.

Regulatory capital requirements and ratios:

Effective October 1, 2009 Jevco assumed the assets and liabilities of KGIC and all intercompany reinsurance agreements between Jevco, KGIC and Kingsway Reinsurance (Bermuda) Limited were commuted. In addition, capital has been injected into Jevco to support the consolidated operations.

As a result of the above transactions, all insurance operations in Canada were consolidated within Jevco with effect from October 1, 2009. During the fourth quarter the Company announced its intent to dispose of its majority stake in Jevco. Subsequent to year end the sale of 100% of Jevco was completed.

In Canada, Jevco is regulated by OSFI. OSFI expects each institution to maintain ongoing capital at no less than the supervisory target Minimum Capital Test (“MCT”) of 150% and may establish, in consultation with an institution, an alternative supervisory target level based upon an individual institution’s risk profile. As at December 31, 2009, Jevco had an MCT of 229% and capital of approximately \$91.0 million in excess of the 150% level.

In the United States, a risk based capital (“RBC”) formula is used by the National Association of Insurance Commissioners (“NAIC”) to identify property and casualty insurance companies that may not be adequately capitalized. The NAIC requires that capital and surplus not fall below 200% of the authorized control level. As at December 31, 2009, based on the unaudited statutory basis financial statements and after reflecting the effect of dividend and capital contributions in January 2010, all U.S. subsidiaries are above the required RBC levels, with RBC ratio estimates ranging between 201% and 38,172%, and have estimated aggregate capital of approximately \$44.5 million in excess of the 200% level.

On October 19, 2009, the Company announced that its indirect wholly owned subsidiary, KAI, has disposed of its entire interest in KAI’s wholly owned subsidiary Walshire. Walshire is the sole shareholder of Lincoln. All of the stock of Walshire has been donated to charity, and with this disposition Lincoln ceases being a member of the Kingsway group of companies. As of the date of the disposition of Walshire, the Company’s control over Walshire and its subsidiaries, including Lincoln, was lost. Accordingly, Walshire and its subsidiaries are no longer consolidated beginning October 19, 2009.

The Company’s obligations in connection with Walshire and its subsidiaries was: a \$10 million cash contribution to Lincoln which was made in the fourth quarter of 2009; continued compliance with a run-off management agreement, including certain continued support to the run-off management team at Lincoln; and continuing guarantee and reinsurance obligations to inter-Company and third party insurance providers in respect of certain Lincoln obligations.

As part of the ongoing transformation program, during the second quarter the Company began terminating all related party reinsurance treaties. As at September 30, 2009, all treaties between Kingsway Reinsurance Corporation and the U.S. operating companies were commuted. As noted above, treaties between the Canadian operating companies and Kingsway Reinsurance (Bermuda) Limited were commuted effective October 1, 2009. These initiatives have resulted in increased capital in the operating companies and it has released excess capital from the captive reinsurers to be used for corporate purposes.

As at December 31, 2009, following the commutation of all intercompany reinsurance treaties between Kingsway Reinsurance Corporation and the Company’s U.S. operating subsidiaries, a significant portion of the remaining capital at Kingsway Reinsurance Corporation was repatriated. A portion of this capital was re-deployed directly into the U.S. operating subsidiaries and a portion was held at the parent company for corporate purposes. The regulatory capital remaining in Kingsway Reinsurance Corporation following the commutation of all related party reinsurance treaties is below the amount required under the Insurance Act of Barbados where Kingsway Reinsurance Corporation is domiciled. The calculation of the minimum capital required is based upon the premiums of the previous calendar year when the level of underwriting activity was significantly greater than those of the ongoing Barbados operation. This situation has been communicated to the Office of the Supervisor of Insurance in Barbados which has accepted the Company’s commitment to resolve the shortfall in early 2010.

As at December 31, 2009, the capital maintained by Kingsway Reinsurance (Bermuda) Limited was approximately \$1.0 million in excess of the regulatory capital requirements in Bermuda.

NOTE 8 HEDGES:

On July 10, 2007, a general partnership of the Company (Kingsway 2007 General Partnership) issued a five year C\$100 million debt obligation due on July 11, 2012 with fixed semi-annual C\$3 million interest payments. Kingsway 2007 General Partnership's risk management objective is to lock in the cash flow requirements on this debt obligation in U.S. dollar terms which is the currency in which its cash inflows are received, thus mitigating exposure to variability in expected future cash flows. In order to meet this objective, Kingsway 2007 General Partnership had entered into a cross-currency swap with Bank of Nova Scotia to swap U.S. dollar cash flows into Canadian dollar cash flows providing the Company with the required Canadian dollar funds each semi-annual period and upon maturity to settle the senior debenture offering interest payments. The swap transaction had been designated as a cash flow hedge. Any changes in the fair value of the hedging instruments were recorded in other comprehensive income until the hedged item affects the Consolidated Statement of Income.

On June 2, 2009, the company discontinued the swap transaction which was designated as a cash flow hedge. Any changes in the fair value of this hedging instrument had been recorded in other comprehensive income. When a cash flow hedge is discontinued, any cumulative adjustment to the hedging instrument that had been recorded through other comprehensive income is recognized in income over the remaining term of the hedged item, or when the hedged item is derecognized. The amount of loss recorded in other comprehensive income at the time of the discontinuance of the cash flow hedge was \$6.2 million before tax of which \$2.1 million has been reclassified to net income for the year ended December 31, 2009.

NOTE 9 CAPITAL ASSETS:

	Cost	Accumulated Amortization	2009 Carrying Value
Land	\$ 4,196	\$ -	\$ 4,196
Buildings	19,113	3,954	15,159
Leasehold improvements	12,139	4,147	7,992
Furniture and equipment	8,043	5,556	2,487
Computer hardware	8,103	7,718	385
Automobiles	343	254	89
Total	\$ 51,937	\$ 21,629	\$ 30,308

	Cost	Accumulated Amortization	2008 Carrying Value
Land	\$ 4,196	\$ -	\$ 4,196
Buildings	19,113	3,363	15,750
Leasehold improvements	12,021	3,377	8,644
Furniture and equipment	5,959	3,756	2,203
Computer hardware	6,056	5,518	538
Automobiles	421	241	180
Total	\$ 47,766	\$ 16,255	\$ 31,511

As discussed in Note 1, in 2009, the Company adopted the CICA Handbook Section 3064. As a result, certain capital assets have been reclassified to intangible assets.

NOTE SHARE CAPITAL:

10

Authorized:

Unlimited number of common shares

Share transactions consist of the following:

	Shares Issued	Stock Options	Weighted- Average Exercise Price*	Amount
Balance as at December 31, 2006	55,884,525	2,344,876	\$ 18.07	\$ 328,473
Stock options:				
Granted in year		571,000	23.00	
Granted in year		25,000	12.08	
Exercised in year	76,303	(76,303)	12.98	880
Forfeited in year		(91,750)	22.30	
Stock-based compensation expense				202
Normal course issuer bid Note 10 (e)	(445,100)			(3,404)
Balance as at December 31, 2007	55,515,728	2,772,823	\$ 19.03	\$ 326,151
Stock options:				
Granted in year		652,350	13.47	
Granted in year		12,000	9.84	
Granted in year		3,000	9.60	
Exercised in year	21,000	(21,000)	4.30	89
Forfeited in year		(92,334)	19.74	
Normal course issuer bid Note 10 (f)	(468,200)			(3,896)
Balance as at December 31, 2008	55,068,528	3,326,839	17.97	322,344
Stock options:				
Granted in year		65,000	1.90	
Granted in year		376,500	10.03	
Expired in year		(333,735)	15.19	
Forfeited in year		(1,410,520)	17.50	
Normal course issuer bid Note 10(f)	(3,472,700)			(27,053)
Balance as at December 31, 2009	51,595,828	2,024,084	16.77	295,291

*Weighted average price is stated in Canadian dollars as per the terms of the option.

- (a) During the year ended December 31, 2009, options to acquire nil shares (2008 - 21,000; 2007 - 76,303 shares) were exercised at nil per share (2008 - C\$4.30 to C\$19.70 per share; 2007 - C\$4.30 to C\$19.70 per share).
- (b) The weighted average number of shares outstanding for the years ended December 31, 2009, 2008 and 2007 were 53,901,615, 55,196,596 and 56,656,913, respectively. On a diluted basis, the weighted average number of shares outstanding for the years ended December 31, 2009, 2008 and 2007 were 53,936,748, 55,250,693 and 55,944,060, respectively.
- (c) During 2009, the Company declared dividends payable in Canadian dollars of C\$0.02 per share payable for the first and second quarter. There were no dividends declared for the second half of 2009. Total dividends declared

in 2009 were C\$0.04 per common share. Dividends paid to common shareholders during 2009 were C\$2,202,741 and C\$16,548,983 in 2008.

- (d) Options exercised during the year resulted in an increase in share capital from contributed surplus of nil for the year ended December 31, 2009 and \$89,000 for the year ended December 31, 2008.
- (e) On November 9, 2007, the Company obtained approval from the TSX to make a normal course issuer bid for its common shares. For the twelve month period commencing November 13, 2007 and ending November 12, 2008, the Company could repurchase up to 2,780,000 of its common shares representing less than 5% of the then outstanding common shares. For the period of November 13, 2007 to December 31, 2007, the Company had repurchased 123,700 of its common shares at an average price of \$16.68. For the year ended, December 31, 2007 the Company had repurchased a total of 445,100 of its common shares at an average price of \$18.20. All of the repurchased common shares were cancelled.
- (f) On November 28, 2008 and amended on July 29, 2009, a normal course issuer bid was approved by the TSX, effective for the twelve month period commencing December 2, 2008 and ending December 1, 2009, whereby the Company could repurchase up to 5,386,545 common shares or approximately 10% of the public float. For the period of December 2, 2008 to December 31, 2008, the Company did not repurchase any common shares. For the year ended, December 31, 2009 the Company had repurchased a total of 3,472,700 of its common shares at an average price of C\$3.77. All of the repurchased common shares were cancelled.

NOTE STOCK-BASED COMPENSATION:

11

- (a) The Company has established a stock option incentive plan for directors, officers and key employees of the Company and its subsidiaries. At December 31, 2009, the maximum number of common shares that may be issued under the plan is 4,800,000 (2008 - 4,800,000) common shares. The maximum number of common shares available for issuance to any one person under the stock option plan is 5% of the common shares outstanding at the time of the grant.

The exercise price is based on the market value of the shares at the time the option is granted. In general, the options vest evenly over a three year period and are exercisable for periods not exceeding 10 years.

The intrinsic value of a stock option grant is the difference between the current market price for the Company's common shares and the exercise price of the option. The aggregate intrinsic values for the stock options outstanding at December 31, 2009, 2008 and 2007 were nil for each year. The aggregate intrinsic values for stock options exercisable at December 31, 2009, 2008 and 2007 were nil for each year.

The following tables summarize information about stock options outstanding as at December 31, 2009, December 31, 2008 and December 31, 2007:

Exercise prices are stated in Canadian dollars as per the terms of the option.

December 31, 2009

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C\$	1.90	05-Mar-09	05-Mar-14	3.9	65,000	-
C\$	10.03	05-Mar-09	05-Mar-14	3.9	257,000	-
C\$	9.60	02-Sep-08	02-Sep-13	3.7	3,000	1,000

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C\$	9.84	12-May-08	12-May-13	3.4	12,000	4,000
C\$	13.47	20-Feb-08	20-Feb-13	3.1	297,350	99,117
C\$	12.08	31-Dec-07	31-Dec-10	1.0	25,000	25,000
C\$	23.00	12-Feb-07	12-Feb-12	2.1	288,500	225,667
C\$	24.55	13-Feb-06	13-Feb-11	1.1	310,000	310,000
C\$	19.70	14-Feb-05	14-Feb-10	0.1	271,034	271,034
C\$	13.53	10-Feb-03	10-Feb-13	3.1	213,000	213,000
C\$	19.66	21-Feb-02	21-Feb-12	2.1	184,500	184,500
C\$	7.80	22-Feb-01	22-Feb-11	1.2	78,500	78,500
C\$	4.30	24-Feb-00	14-Feb-10	0.2	19,200	19,200
	Total			2.2	2,024,084	1,431,018

December 31, 2008

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C\$	9.60	02-Sep-08	02-Sep-13	4.7	3,000	-
C\$	9.84	12-May-08	12-May-13	4.4	12,000	-
C\$	13.47	20-Feb-08	20-Feb-13	4.1	639,850	-
C\$	12.08	31-Dec-07	31-Dec-10	2.0	25,000	25,000
C\$	23.00	12-Feb-07	12-Feb-12	3.1	535,250	245,083
C\$	24.55	13-Feb-06	13-Feb-11	2.1	540,100	393,400
C\$	19.70	14-Feb-05	14-Feb-10	1.1	455,867	455,867
C\$	15.19	12-Feb-04	12-Feb-09	0.1	333,735	333,735
C\$	13.53	10-Feb-03	10-Feb-13	4.1	315,334	315,334
C\$	19.66	21-Feb-02	21-Feb-12	3.1	287,000	287,000
C\$	7.80	22-Feb-01	22-Feb-11	2.2	122,002	122,002
C\$	4.30	24-Feb-00	14-Feb-10	1.2	57,701	57,701
	Total			2.6	3,326,839	2,235,122

December 31, 2007

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C\$	12.08	31-Dec-07	31-Dec-10	3.0	25,000	25,000
C\$	23.00	12-Feb-07	12-Feb-12	4.1	552,750	-
C\$	24.55	13-Feb-06	13-Feb-11	3.1	558,600	186,200
C\$	19.70	14-Feb-05	14-Feb-10	2.1	478,700	316,033
C\$	15.19	12-Feb-04	12-Feb-09	1.1	342,736	342,736
C\$	13.53	10-Feb-03	10-Feb-13	5.1	319,334	319,334

C\$	21-Feb-02	21-Feb-12			
19.66			4.2	295,000	295,000
C\$	22-Feb-01	22-Feb-11			
7.80			3.2	122,002	122,002
C\$	24-Feb-00	14-Feb-10			
4.30			2.2	78,701	78,701
Total			3.2	2,772,823	1,685,006

At December 31, 2009, 2008 and 2007 the number of options exercisable were 1,431,017, 2,235,122 and 1,685,006, respectively, with weighted average prices of C\$18.89, C\$18.23 and C\$16.45, respectively.

The Company determines the fair values of options granted using the Black-Scholes option pricing model. During March 2009, the Company issued two option grants at varying exercise prices. Per share fair value of these grants was C\$0.97 and C\$0.45. Fair value of options granted in February 2008 was C\$2.88, May 2008 was C\$2.43 and September 2008 was C\$2.45. Fair value of options granted in February 2007 was C\$ 5.34 and in December 2007 was C\$2.38.

The Company does not record any compensation expense for stock options granted prior to 2003. When these stock options are exercised, the Company will include the amount of proceeds in share capital. The impact on net income and earnings per share if the Company had measured the compensation element of stock options granted based on the fair value on the date of grant on all outstanding stock options on their grant date is disclosed as follows:

	2009	2008	2007
Stock option adjustment included in employee compensation expense	\$ (4,186)	\$ 2,172	\$ 2,468
Net loss, as reported	\$(290,287)	\$(405,865)	\$(18,526)
Pro forma net loss	\$(290,287)	\$(405,865)	\$(18,526)
Basic earnings (loss) per share			
As reported	\$ (5.38)	\$ (7.35)	\$ (0.32)
Pro forma	(5.38)	(7.35)	(0.32)
Diluted loss per share			
As reported	\$ (5.38)	\$ (7.35)	\$ (0.32)
Pro forma	(5.38)	(7.35)	(0.32)

Stock option expense above is charged to earnings and is included as a separate component of Shareholders' Equity under the caption "Contributed Surplus".

The fair value of the options granted was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Mar 2009	Sep 2008	May 2008	Feb 2008	Dec 2007	Feb 2007
Risk-free interest rate	1.78 %	2.91 %	3.03 %	3.22 %	3.82 %	4.11 %
Dividend yield	4.21 %	3.1 %	3.1 %	2.2 %	2.5 %	1.3 %
Volatility of the expected market price of the Company's common shares	88.1 %	37.6 %	35.8 %	27.8 %	28.8 %	25.2 %
Expected option life (in years)	4.0	4.0	4.0	4.0	3.0	4.0

The Black-Scholes option valuation model was developed for use in estimating fair value of traded options that have no vesting restrictions and are fully transferable. As the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the above pro forma adjustments are not necessarily a reliable single measure of the fair value of the Company's employee stock options.

(b) The Company has an employee share purchase plan where qualifying employees can choose each year to have up to 5% of their annual base earnings withheld to purchase the Company's common shares. The Company matches one half of the employee contribution amount, and its contributions vest immediately. All contributions are used by the plan administrator to purchase common shares in the open market. The Company's contribution is expensed as paid and for the years ended December 31, 2009, 2008 and 2007 totaled \$556,000, \$840,000 and \$885,000, respectively.

(c) Effective May 2008, the company has a deferred share unit ("DSU") program. The purpose of the DSU program is to promote a greater alignment of interests between members of the Board and the shareholders of the Company. As such, one-half of the annual retainer fee for serving as a member of the board will be credited as DSU. In addition, each director has the option to choose to receive all or a percentage of their remaining annual remuneration in DSUs.

DSUs are credited to an account maintained for each director by the Company. The number of DSUs to be credited is determined by dividing the amount of the director's remuneration to be deferred into DSUs on that date by the closing TSX share price on that day.

A director who has terminated service may redeem the DSUs credited to the director's account on or before December 15th in the year subsequent to the year the eligible director terminated service. The Company will make a lump sum cash payment (net of any applicable withholdings or deductions) equal to the number of DSUs credited to the director's account as of the filing date of the notice of redemption of the DSUs multiplied by the fair market value per share.

The total number of DSUs held, for the years ended December 31, 2009, 2008, 2007 was 87,450, 32,327 and nil, respectively. The program was terminated effective January 1, 2010.

NOTE PENSION BENEFITS:

12

The Company maintains separate defined contribution pension plans in Canada and in the U.S. for all of its qualified employees including the employees of all subsidiaries. In Canada, qualifying employees can choose each year to have up to 5% of their annual base earnings subject to the maximum Registered Retirement Savings Plan (“RRSP”) deduction limit, withheld to contribute to the applicable plan. The RRSP deduction limit is the lesser of 18% of earned income for the preceding year or C\$21,000, C\$20,000 and C\$19,000 for 2009, 2008 and 2007 respectively. The Company matches one half of the employee contribution amount, and its contributions vest immediately. In the U.S., qualifying employees can choose to voluntarily contribute up to 60% of their annual earnings subject to an overall limitation of \$16,500 in 2009, \$15,500 in 2008 and \$15,500 in 2007. The Company matches 50% of the employee contribution amount each payroll period up to 5%.

The contributions for the U.S. plan vest based on years of service with 100% vesting after five years of service. The Company’s contribution is expensed as paid and for the years ended December 31, 2009, 2008 and 2007 totaled \$1,471,000, \$1,643,000, and \$1,389,000, respectively. All Company obligations to the plans were fully funded as of December 31, 2009.

Prior to December 31, 1997, substantially all salaried employees of the Company’s subsidiary American Country were covered by a defined benefit pension plan sponsored by American Country. Effective December 31, 1997, upon resolution of its Board of Directors, the plan was frozen. The reported pension expense for American Country was \$121,000, \$53,000 and \$25,000 in 2009, 2008, and 2007 respectively.

NOTE UNDERWRITING POLICY AND REINSURANCE CEDED:

13

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophe or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. The Company is not relieved of its primary obligation to the policyholder as a result of the reinsurance transaction.

Failure of reinsurers to honour their obligations could result in losses to the Company. Consequently, the Company continually evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses from reinsurer insolvency.

Underwriting risk:

Underwriting risk is the risk that the total cost of claims and acquisition expenses will exceed premiums received and can arise from numerous factors, including pricing risk, reserving risk, catastrophic risk, catastrophic loss risk and reinsurance coverage risk.

The Company’s underwriting objective is to develop business within a target market on a prudent and diversified basis and to achieve profitable underwriting results (i.e. a combined ratio between 95% and 100%)

Pricing risk:

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. Historically, the underwriting results of the property and casualty industry have fluctuated significantly due to the cyclical nature of the insurance market. The market cycle is affected by the frequency and severity of losses, levels of capacity and demand, general economic conditions and price competition. The Company focuses on profitable underwriting using a combination of experienced underwriting staff, pricing models and price adequacy monitoring tools. The products are priced taking into account numerous factors including claims frequency and severity trends, product line expense ratios, special risk factors, the capital required to support the product line, and the investment income earned on that capital. The Company's pricing is designed to ensure an appropriate return on capital while also providing long-term rate stability. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

Reinsurance risk:

The Company relies on reinsurance to manage the underwriting risk; however, reinsurance does not release the Company from its primary commitments to its policyholders. Therefore, the Company is exposed to the credit risk associated with the amounts ceded to reinsurers. The Company assesses the financial soundness of the reinsurers before signing any reinsurance treaties and monitors their situation on a regular basis. In addition, the Company has minimum rating requirements for its reinsurers. The Company tenders reinsurance requirements on a regular basis to ensure that the best price possible is obtained. The Company works with well established reinsurers that have expertise in their field as well as an understanding of the business. Management reviews reinsurance programs to manage cost efficiency and reduce the likelihood of coverage gaps.

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits the Company's net exposure to the following maximum amounts:

Years ended December 31

	2009	2008	2007
Property claims	\$ 500	\$ 500	\$ 500
Casualty claims	\$ 1,000	\$ 1,000	\$ 1,000

In addition, the Company has obtained catastrophe reinsurance protection which provides coverage in the event of a series of events. This reinsurance limits its net retained exposure and provides coverage up to certain maximum per occurrence amounts in excess of the retained loss as follows:

Years ended December 31

	2009	2008	2007
Retained loss	\$ 2,000	\$ 2,000	\$ 5,000
Maximum coverage	\$ 38,000	\$ 38,000	\$ 20,000

The unearned premium balance is affected by the reinsurance ceded as a portion of the unearned premium will be owed to the reinsurer as the premiums are earned in the subsequent periods. The amounts deducted for reinsurance ceded from net premiums earned, claims incurred and commissions and premium taxes for the years ended December 31, 2008, 2007 and 2006 were as follows:

	2009	2008	2007
Net premiums earned	\$ 12,393	\$ 12,043	\$ 11,785
Claims incurred	412	1,319	1,234
Commissions and premium taxes	11,658	15,373	8,419

The amounts of assumed premiums written were \$14,439,000, \$36,829,000 and \$39,587,000 for the years ended December 31, 2009, 2008 and 2007, respectively. The amounts of assumed premiums earned were \$18,146,000,

\$44,548,000 and \$32,536,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

NOTE INCOME TAXES:

14

(a) The Company's provision for income taxes, compared to statutory rates is summarized as follows:

	2009	2008	2007
Provision for taxes at Canadian statutory marginal income tax rate	\$(45,128)	\$(38,243)	\$(16,685)
Valuation allowance	21,739	67,676	-
Non-taxable investment income	(59)	(580)	(351)
Foreign operations subject to different tax rates	11,267	11,847	(2,923)
Change in tax rates and other	(18,229)	(12,095)	15,726
Provision for income taxes for continuing operations	\$(30,410)	\$ 28,605	\$ (4,233)

(b) The components of future income tax balances are as follows:

	2009	2008
Future income tax assets:		
Losses carried forward	\$ 235,604	\$ 88,682
Unpaid claims and unearned premiums	24,920	16,649
Securities	2,314	8,041
Profit commission accruals	237	2,014
Other	2,969	4,442
Valuation allowance	(242,756)	(96,221)
Future income tax assets	23,288	23,607
Deferred policy acquisition costs	(6,255)	(5,800)
Securities	(5,253)	(727)
Guaranteed payments	-	(1,240)
Other	(2,299)	-
Future income tax liabilities	(13,807)	(7,767)
Net future income tax assets	\$ 9,481	\$ 15,840

66

(c) Amounts and expiration dates of the operating loss carry forwards are as follows:

	Year of net operating loss	Expiration date	Net operating loss
U.S. operations:	1997	2012	1,284
	2000	2020	507
	2001	2021	14,898
	2002	2022	4,367
	2003	2023	202
	2004	2024	138
	2005	2025	41
	2006	2026	32,268
	2007	2027	70,113
	2008	2028	55,010
	2009	2029	501,856

In addition, there are operating loss carry forwards relating to the operations in Barbados in the amount of \$88,351,000. All of these losses will expire in 2018.

(d) The Company established valuation allowances of \$242,755,000 (U.S. Operations - \$239,583,000; Other - \$3,172,000) and \$67,676,000 (U.S. Operations - \$67,676,000; Other - nil) for its gross future tax assets at December 31, 2009 and 2008, respectively. Based on the Company's expectations of taxable income, its ability to change its investment strategy, as well as reversing gross future tax liabilities, management believes it is more likely than not that the Company will fully realize the net future tax assets (Canadian operations - \$8,283,000 U.S. operations - \$1,198,000), with the exception of the aforementioned valuation allowance. The Company has, therefore established the valuation allowance at December 31, 2009 mainly as a result of the potential inability to utilize a portion of its net operating losses in the U.S. that do not expire for up to 20 years. The uncertainty over the Company's ability to utilize a portion of these losses over the short term has led to the Company recording valuation allowances.

NOTE UNPAID CLAIMS:

15

(a) Nature of unpaid claims:

The establishment of the estimated provision for unpaid claims is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors

include the Company's experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims, product mix or concentration, claims severity and claim frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claims departments' personnel and independent adjusters retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination, since the longer the span between the incidence of a loss and the payment, or settlement of the claims, the more variable the ultimate settlement amount can be. Accordingly, short tail claims such as property claims, tend to be more reasonably predictable than long tail claims, such as general liability and automobile accident benefit claims that are less predictable.

Consequently, the process of establishing the estimated provision for unpaid claims is complex and imprecise as it relies on the judgment and opinions of a large number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provision necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made.

(b) Provision for unpaid claims:

The Company's annual evaluation of the adequacy of unpaid claims includes a re-estimation of the liability for unpaid claims relating to each preceding financial year compared to the liability that was originally established. The results of this comparison and the changes in the provision for unpaid claims, net of amounts recoverable from reinsurers, for the years ended December 31, 2009, 2008 and 2007 were as follows:

	2009	2008	2007
Unpaid claims - beginning of year net	\$ 368,888	\$ 392,070	\$ 317,019
Net unpaid claims of subsidiaries acquired	-	-	65,332
Provision for claims occurring:			
In the current year	334,540	380,095	360,318
In prior years	21,548	(5,364)	(5,602)
Claims paid during the year relating to:			
The current year	(168,142)	(209,372)	(216,306)
The prior years	(192,522)	(188,541)	(128,691)
Unpaid claims - end of year net	364,312	368,888	392,070
Reinsurers' and other insurers' share of unpaid claims	4,188	5,911	6,293
Unpaid claims - end of year	\$ 368,501	\$ 374,799	\$ 398,363

The results for the year ended December 31, 2009, were adversely affected by the evaluation of unpaid claims related to prior years.

The Company reported unfavourable reserve development of \$21.5 million in 2009 compared to a favourable development of \$5.4 million in 2008. Non Standard Auto business contributed \$14.8 million of the prior years' claims development in 2009, compared to a favourable claims development \$3.9 million in 2008 and a favourable claims development of \$4.4 million in 2007. Property and liability business favourably contributed \$1.2 million of the prior years' claims development in 2009, compared to a favourable contribution of \$1.0 million in 2008 and a favourable contribution of \$1.2 million in 2007.

(c) Ranges of unpaid claims:

In accordance with actuarial standards for 2009 and 2008, the independent appointed actuary develops a variability of the reserve estimates, more commonly known as a range of reasonable reserve estimates, and a recommended actuarial central estimate of reserves. The actuarial central estimate is intended to represent the independent appointed actuary's best estimate and will not necessarily be at the mid-point of the high and low estimates of the range. The

range of reasonable reserve estimates reflects the uncertainties associated with analyzing the reserves, and includes estimates that could be produced by appropriate actuarial methods and assumptions. This range does not reflect the range of all possible outcomes. Actual results outside of this range are possible.

The ranges of provision for gross unpaid claims for U.S. operations estimated by our independent actuary and the actual carried provision for unpaid claims were as follows:

	Low	High	Actuarial Central Estimate	Carried
As at December 31, 2009	\$ 336,947	\$ 403,218	\$ 368,479	\$ 367,324
As at December 31, 2008	\$ 334,819	\$ 407,241	\$ 370,085	\$ 374,295

In addition, the Company has carried a provision for unpaid claims at Kingsway Reinsurance Corporation of \$1,177,000 and \$504,000 at December 31, 2009 and 2008 respectively. The Company's total unpaid claims provision was \$368,501,000 and \$374,799,000 at December 31, 2009 and 2008 respectively.

As part of the reserving process, the external independent actuary performs various quarterly reviews throughout the calendar year to assess whether the actual results of the operating insurance company are materially different than what was expected based on loss development factors previously established.

As the processes of management and the external independent actuary are undertaken independently, the provision for unpaid claims recorded by management can differ from the independent actuary's central estimate. Prior to the fourth quarter of 2009, the Company and each one of its subsidiaries operated under a policy whereby, to the extent that management's estimate of its gross provision for unpaid claims (net of salvage and subrogation) at December 31 of each year was less than the actuarial central estimate as recommended by its independent appointed actuary, the Company increased the gross provision for unpaid claims to an amount that was not less than the final actuarial central estimate of each subsidiary as recommended by the independent appointed actuary. In the fourth quarter of 2009, each subsidiary recorded management's estimate of unpaid claims and the Company adjusted the consolidated Company's unpaid claims by the aggregate difference between management's estimate of unpaid claims and the aggregate actuarial central estimate.

Beginning in 2010, the Company will no longer operate under the policy described above of adjusting reserves to reflect the independent actuary's central estimate. Comparing management's selected reserve estimate to the actuarial central estimate and range of reasonable reserves independently determined by the appointed actuary continues to be an important step in the reserving process, however, where differences exist and the Company believes the internally developed reserve estimate to be more accurate, management's estimate will not be changed. We believe this to be consistent with industry practice for companies with a robust reserving process in place.

As at December 31, 2009, the aggregate amount by which the appointed actuary's central estimate exceeded management's selected reserve estimate was \$6.6 million. Because of the change in policy described above, the provision for unpaid claims has not been increased or decreased in the financial statements of the subsidiaries where management's reserve estimate is lower or higher than that of the actuarial central estimate. The Company elected to increase the consolidated reserves by \$6.6 million to reflect the above difference on a consolidated basis in order to present the financial position of the consolidated Company on a consistent basis throughout the year.

NOTE SEGMENTED INFORMATION:

16

The Company provides property and casualty insurance. Previously, the Company managed these businesses in three reportable segments: Canada, the United States and Corporate. As a result of implementing its corporate restructuring plans, exiting non-core businesses and the sale of its remaining Canadian operations, the Company now manages its business in the following three segments: the United States, Business in Run-Off and Corporate. The United States segment consists of U.S. operations and includes transactions with one of the Company's reinsurance subsidiaries. The business in Run-Off is comprised of the Southern United Fire Insurance Company Inc. business. Results for the Company's operating segments are based on the Company's internal financial reporting systems and are consistent with those followed in the preparation of the consolidated financial statements.

The segmented information for December 31, 2009 is summarized as follows:

	United States	Run-Off	Corporate	Total
Gross premiums written	\$ 369,576	\$ 7,216	\$ -	\$ 376,792

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Net premiums earned	410,690	19,531	-	430,221
Investment income (loss)	16,078	477	(13,827)	2,728
Net realized gain (loss)	10,239	11	(2)	10,248
Interest expense	23,912	-	-	23,912
Amortization of capital assets	2,664	42	502	3,208
Amortization of intangible assets and goodwill impairment	8,301	17	2,332	10,650
Income tax expense (recovery)	(15,022)	-	(15,388)	(30,410)
Loss from continuing operations	(55,811)	(10,011)	(40,518)	(106,340)
Total assets (excluding assets held for sale)*	\$ 756,372	\$ 33,938	\$ 21,564	\$ 811,874

* Total assets were \$1,957,355 and assets held for sale were \$1,145,481

The segmented information for December 31, 2008 is summarized as follows:

	United States	Run-Off	Corporate	Total
Gross premiums written	\$ 470,490	\$ 53,701	\$ -	\$ 524,191
Net premiums earned	470,761	54,055	-	524,816
Investment income (loss)	34,298	528	485	35,311
Net realized gain (loss)	(11,211)	9	-	(11,202)
Interest expense	31,094	-	3,928	35,022
Amortization of capital assets	2,729	99	1,529	4,357
Amortization of intangible assets and goodwill impairment	56,996	17	3,455	60,468
Income tax expense (recovery)	43,393	-	(14,788)	28,605
Income (loss) from continuing operations	(122,422)	(14,513)	(5,832)	(142,767)
Total assets (excluding assets held for sale)*	\$ 902,930	\$ 73,571	\$ 44,576	\$ 1,021,077

* Total assets were \$3,343,441 and assets held for sale were \$2,322,364

The segmented information for December 31, 2007 is summarized as follows:

	United States	Run-Off	Corporate	Total
Gross premiums written	\$ 468,489	\$ 41,653	\$ -	\$ 510,142
Net premiums earned	463,132	36,969	-	500,101
Investment income (loss)	43,110	514	(1,381)	42,243
Net realized gain (loss)	2,267	(51)	(9)	2,207
Interest expense	30,263	-	8,605	38,868
Amortization of capital assets	2,097	(58)	2,860	4,899
Amortization of intangible assets and goodwill impairment	5,283	158	1,726	7,167
Income tax expense (recovery)	(10,312)	-	6,079	(4,233)
Income (loss) from continuing operations	2,641	(7,386)	(37,248)	(41,993)
Total assets (excluding assets held for sale)*	\$ 892,651	\$ 71,520	\$ 41,431	\$ 1,005,602

* Total assets were \$4,657,405 and assets held for sale were \$3,651,803

The Company's gross premiums written are derived from the following business lines and geographical areas:

	2009	2008	2007
Business Line			
Personal Lines:			
Non-standard Auto	77.2%	74.8%	70.8%
Property (including Liability)	2.3%	1.7%	1.7%
Total Personal Lines	79.5%	76.5%	72.5%
Commercial Lines:			
Commercial Auto	18.0%	22.7%	26.0%
Property (including Liability)	0.2%	0.8%	1.3%
Other Specialty Lines	2.3%	0.0%	0.2%
Total Commercial Lines	20.5%	23.5%	27.5%
Total Gross Premiums Written	100%	100%	100%

	2009	2008	2007
Geographical Area			
United States:			
Florida	25.5%	21.8%	23.3%
Illinois	22.9%	20.6%	25.0%
California	9.7%	9.6%	7.8%
Virginia	5.1%	4.4%	3.9%
Texas	4.4%	6.0%	6.9%
Colorado	4.1%	2.5%	2.0%
Missouri	3.2%	2.4%	1.1%

New York	3.2%	2.6%	2.4%
Other	21.9%	30.1%	27.6%
Total Gross Premiums Written	100%	100%	100%

NOTE INDEBTEDNESS:

17

(a) Bank indebtedness:

On June 23, 2006, the Company entered into a \$175.0 million 3 year revolving facility with a syndicate of three banks. This facility replaced a C\$150.0 million 364 day revolving credit facility. During 2008, the Company repaid all outstanding amounts under this facility and the facility was terminated.

On December 21, 2007, the Company entered into a 365 day C\$70.0 million credit facility with a syndicate of banks. This facility is supplemental to the existing \$175.0 million credit facility above. During 2008, the Company repaid all outstanding amounts under this facility and the facility was terminated.

71

(b) Senior unsecured debentures:

On January 29, 2004, a subsidiary of the Company, KAI, completed the sale of \$100.0 million 7.50% senior notes due 2014. The notes are fully and unconditionally guaranteed by the Company. The notes are redeemable at KAI's option beginning February 1, 2009. In March 2004 an additional \$25.0 million of these senior notes were issued. Interest paid during the year was \$9,193,000, \$9,375,000 for 2008 and \$9,375,000 for 2007 with an effective weighted average interest rate of 8.27%.

During 2009 and 2008, the Company repurchased \$7.0 million and \$17.5 million of par value of this offering and realized a gain on the repurchases of \$3.5 million in 2009 and \$0.7 million, respectively. As at December 31, 2009 \$100.5 million of this issue remains outstanding.

Subsequent to year end, on March 30, 2010, the company repurchased \$47.9 million of par value of this offering, realizing a gain of \$9.5 million. These trades had been contingent upon the closing of the Jevco sale transaction.

On July 10, 2007, a general partnership of the Company, Kingsway 2007 General Partnership issued C\$100.0 million Senior Unsecured Debentures at 6% due on July 11, 2012. These debentures bear interest at a fixed rate of 6% per annum payable semi-annually from the date of issuance until July 11, 2012. Interest payments are to be made on January 10 and July 10 of each year, commencing January 10, 2008 with an effective interest rate of 6.3%. The net proceeds to the Company amounted to C\$99,188,000. Kingsway 2007 General Partnership may redeem the debentures in whole at any time and in part from time to time, at the issuer's option. The debentures are unconditionally guaranteed by the Company and KAI.

Both of these senior unsecured debentures contain negative covenants in their trust indentures placing limitations and restrictions over certain actions without the prior written consent of the indenture trustees. For additional details of these covenants and the Company's non-compliance with the debt to capital thresholds see Note 7.

During 2009, the Company repurchased \$14.6 million (C\$16.1 million) of par value of this offering and realized a gain of \$6.0 million. As at December 31, 2009 C\$83.9 million of this issue remains outstanding.

Subsequent to year end, as described in Notes 4 and 27(b), on March 30, 2010, the company repurchased \$36.9 million (C\$37.5 million) of par value of this offering, realizing a gain of \$6.2 million. These trades had been contingent upon the closing of the Jevco sale transaction.

(c) Subordinated indebtedness:

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of the Company issued \$90.5 million of 30 year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America Inc. to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the rate of the London interbank offered interest rate for three month U.S. dollar deposits, plus spreads ranging from 3.85% to 4.20%, but until dates ranging from December 4, 2007 to January 8, 2009, the interest rates will not exceed 12.45% to 12.75%. The Company has the right to call each of these securities at par anytime after five years from their issuance until their maturity. The net proceeds to the Company were \$70,877,000 after deducting expenses of \$4,625,000. Interest paid during the year was \$5,047,000, \$7,126,000 for 2008 and \$8,896,000 for 2007.

(d) Loans payable:

On July 14, 2005 Kingsway Linked Return of Capital Trust (“KLROC Trust”) completed its public offering of C\$78.0 million of 5.00% Kingsway Linked Return of Capital Preferred Units (“KLROC Units”) due June 30, 2015 of which the Company was a promoter. The net proceeds of the offering were used by KLROC Trust for a series of investments that included the purchase of a C\$74.1 million 7.12% senior note due June 30, 2015 issued by an affiliate. Because the Company is not considered to be the primary beneficiary of the KLROC Trust, the KLROC Units are not considered to be an obligation of the consolidated entity.

KAI, a U.S. subsidiary, has a promissory note payable balance of approximately \$66.2 million with Kingsway ROC LLC, an affiliated company. The note was issued on July 15, 2005 and bears interest at 7.37% annually. The note principal is payable on June 30, 2015. Interest paid during the year was \$4,881,000 and \$4,881,000 for 2008 and 2007 with an effective interest rate of 7.37%. Because the Company is not considered to be the primary beneficiary of ROC LLC, the promissory note payable to the ROC LLC is considered to be an obligation of the consolidated entity.

On June 26, 2009, KFS Capital LLC, an indirect wholly-owned subsidiary of the Company commenced a take-over bid. Together with 136,500 KLROC Units acquired outside of the KLROC Offer, the Company now owns and controls approximately 26.6% of the issued and outstanding KLROC Units at December 31, 2009. Because the amount owing to ROC LLC under the terms of the promissory note payable is unchanged through the acquisition of these KLROC Units, the balance of the Loan Payable is not reduced. The securities portfolio of the consolidated portfolio includes KFS Capital LLC's investment in the KLROC Units. The Company earned \$0.2 million of investment income on these KLROC Units during 2009.

(e) Financing facility:

In March 2009, the Company obtained a \$20 million financing facility from American Physicians Assurance Corporation ("AP Assurance") to allow for specific capital initiatives. Two of the members of the Company's Board of Directors also sit on the board of AP Assurance making it a related party. The facility was at fair market terms and conditions. As at September 30, 2009, the facility was undrawn, expired and has been terminated. In the fourth quarter of 2009, a new facility has been obtained from the same related party. This new facility is at fair market terms and conditions. No funds were ever drawn on this facility and it was withdrawn on February 25, 2010.

(f) Contractual obligations:

The table below provides a breakdown of contractual obligations as described above in items (a) - (d):

	2009	2008
Senior unsecured debentures	\$ 176,764	\$ 185,203
Subordinated indebtedness	87,414	87,383
Loan payable	66,222	66,222
Total	\$ 330,400	\$ 338,808

Refer to Note 6 for a maturity schedule of these contractual obligations.

NOTE VARIABLE INTEREST ENTITIES:

18

Variable interest entities include entities where the equity invested in the entity is considered insufficient to finance the entity's activities. The Company has controlled entities which are variable interest entities and two such entities are not consolidated based on accounting standards as the Company is not considered to be the primary beneficiary. The Company accounts for its investment in these entities using the equity method and includes the investment in other assets on the Consolidated Balance Sheet. The Company's share of earnings in these entities is included in net investment income in the Consolidated Statement of Operations. As the funds invested in this non-consolidated affiliated entity formed part of the C\$74.1 million note referred to in Note 17(d), the effect of this transaction is to show additional debt on the Company's financial statements and an offsetting equity investment of C\$8.3 million in the non-consolidated affiliated entity.

NOTE COMMITMENTS AND CONTINGENT LIABILITIES:

19

(a)

Legal proceedings:

In connection with its operations, the Company and its subsidiaries are, from time to time, named as defendants in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal damages or expense in excess of amounts provided and the Company does not believe that it will incur any significant additional loss or expense in connection with such actions.

73

In addition to the potential exposures outlined above, the Company is engaged in the following legal disputes:

(i) The DOI has challenged the disposition to charities of Walshire and its subsidiaries. On November 20, 2009, DOI filed a complaint in the Commonwealth Court against the Company, KAI and Walshire, seeking a declaration that the disposition was unlawful and not valid. The Company disagrees with the DOI's position and maintains that the donations of Walshire shares to the charities were lawful and valid. On November 19, 2009, the day before the DOI's complaint, the Company and KAI filed a complaint in the Commonwealth Court against the DOI seeking a declaration that the statute upon which the DOI principally relies did not apply to the donations. In response to the Company's complaint, the DOI filed a New Matter (in essence, a Counterclaim). The Company has demurred to each of the claims in the DOI's complaint, thereby putting the legal sufficiency of the DOI's claims at issue. The demurrers were argued to a panel of the Commonwealth Court on February 9, 2010, which has reserved its decision.

As disclosed in Note 4, if the demurrers are unsuccessful, the complaints would proceed through the courts in due course and the outcome of this case at trial is not determinable. If the ultimate decision of the courts is unfavorable for the Company, the control of Lincoln may revert back to the Company, which would result in Lincoln's financial results being included in the Company's consolidated financial statements. If the Commonwealth Court or a higher court deems the transaction to be invalid, it could ultimately lead to the Company being in breach of its public debt covenants should Lincoln go into liquidation while still part of the Company. The Company's public debt is material, and a breach in covenants could lead to the liquidation of the Company if principal and interest payments are called before maturity.

(ii) The external run-off manager of Lincoln has asserted that the Company has violated the terms of the run-off agreement and has filed a request for arbitration for the maximum payable under the contract of \$20 million. The Company management believes that the Company is in compliance with the terms of the run-off agreement.

(iii) The Company is the defendant in two separate breach of contract suits filed by two former employees.

(b) Letters of credit:

The Company has a syndicate letter of credit facility which is used to collateralize reinsurance balances. The Company pledges securities to collateralize the utilized portion of the letter of credit facility. At December 31, 2009 the letter of credit facility utilization was \$1.8 million.

(c) Charitable donations:

In 2004, the Company agreed to make a gift contribution of C\$3.0 million to the Trillium Health Centre Foundation ("Trillium") to be payable in equal installments over the period of six years beginning in 2005. This contribution is being used to operate the Kingsway Financial Spine Centre in Mississauga, Ontario and is expensed as paid. In 2009, the Company issued a payment of C\$0.3 million and has informed Trillium that it will no longer make any further contributions.

(d) Guarantees:

The Company provided a guarantee for the payment of principal and interest for a non-controlled affiliated entity which entered into a cross-currency swap transaction on July 14, 2005 in conjunction with the Kingsway Linked Return of Capital Trust transaction described in Note 17(d) whereby the affiliate swapped fixed Canadian dollar

payments for fixed U.S. dollar payments. The guarantee extends until the swap agreement terminates on June 30, 2015.

As described in Note 22, the Company and Lincoln entered into a contractual obligation for consulting services with an external run-off manager. The Company provided a guarantee for payment of management fees by Lincoln to the run-off manager. The amount potentially payable under the guarantee is approximately \$2.0 million and represents the maximum potential future payments that the Company would be required to make under the guarantee. No accrual has been made for this guarantee at December 31, 2009. The publicly available unaudited statutory financial statements of Lincoln, reflect a statutory surplus of \$2.1 million and total liabilities of \$704.3 million after reporting unpaid claims on a discounted basis as permitted by the DOI. These ongoing obligations are not significant and do not provide the Company with any control or significant influence over the operating activities or financial results of Lincoln.

The Company also provided a letter of guarantee to a third party for Customs bonds reinsured by Lincoln. This guarantee may require the Company to compensate the third party if Lincoln is unable to fulfill its obligations relating to the Customs bonds. The Company's expense under this contingency is not determinable and no liability is reflected in the financial statements at December 31, 2009.

The Company, through one of its subsidiaries acts as a Managing General Agent for certain Lincoln programs. Any contingent payment to Lincoln is dependent on the ultimate loss and settlement amount of the reserves held for these programs. The Company's expense under this contingency is not determinable and no liability is reflected in the financial statements at December 31, 2009. These ongoing obligations are not significant and do not provide the Company with any control or significant influence over the operating activities or financial results of Lincoln.

(e) Collateral pledged:

As at December 31, 2009, bonds and term deposits with an estimated fair value of \$39.0 million (2008 - \$54.1 million) were on deposit with state and provincial regulatory authorities. Also, from time to time, the Company pledges securities to third parties to collateralize liabilities incurred under its policies of insurance. At December 31, 2009, the amount of such pledged securities was \$8.9 million (2008 - \$109.9 million). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company's standard risk management controls.

(f) Collateral held:

In the normal course of business, the Company receives collateral on certain business transactions to reduce its exposure to credit risk. As at December 31, 2009, the amount of such pledged securities was \$1.3 million (2008 - \$0.7 million). The Company is normally permitted to sell or repledge the collateral it receives under terms that are common and customary to standard collateral holding and are subject to the Company's standard risk management controls.

(g) Future minimum lease payments:

Future minimum annual lease payments under operating leases for premises/equipment for the next five years and thereafter are:

2010	\$ 3,346
2011	3,395
2012	3,144
2013	2,750
2014	2,726
Thereafter	6,151

GOODWILL AND INTANGIBLE ASSETS:

NOTE

20

(a) Goodwill:

As described in Note 4, in 2009, the purchase price for Jevco was less than its book value, as a result, the Company wrote down the value of its remaining goodwill to nil. The amount of the related write down was \$6.9 million which is included in the income (loss) from discontinued operations, net of taxes line item on the statement of operations.

In 2008, the Company performed the annual goodwill impairment test and it was determined that the carrying amount of goodwill for the U.S. Reporting Segment exceeded its fair value. As a result, the Company recorded in operating income a non-cash goodwill impairment charge of \$50,074,000 relating to this goodwill. The determination that the fair value of goodwill was less than its carrying value resulted from a decline in market multiples, both from an industry and Company perspective, and a reduction of fair value as determined using the discounted cash flow methodology, incorporating both current Company and market assumptions, which in combination resulted in the goodwill impairment.

75

(b) Intangible assets:

The intangible assets with indefinite useful lives for 2009 were \$10,053,000 (2008 - \$10,053,000). These intangible assets relate to insurance licenses and are not amortized.

The intangible assets with definite useful lives are comprised of agent relationships, technology-based asset, renewal rights, income streams and computer software, which are amortized over their estimated useful lives, and net of accumulated amortization for 2009 were \$27,520,000 (2008 - \$40,162,000). The agent relationships intangible asset is being amortized over a five year term based on the pattern in which the economic benefits of the intangible asset are expected to be consumed. The technology based intangible, renewal rights and income streams intangible assets are amortized on a straight-line basis over 41 months, 10 years and 20 years respectively, while computer software is amortized over 18 months to 5 years. Amortization of intangible assets for 2009 was \$10,650,000 (2008 - \$10,394,000 and 2007 - \$7,167,000).

As described in Note 4, in 2009, as a result of the sale of specific assets of Avalon, the Company wrote off the associated remaining intangible assets of \$1,590,000. There was no write-down of intangible assets due to impairment for the years 2008 and 2007.

NOTE RECONCILIATION OF CANADIAN AND UNITED STATES GENERALLY ACCEPTED
21 ACCOUNTING PRINCIPLES:

The consolidated financial statements of the Company have been prepared in accordance with Canadian GAAP. The significant differences between Canadian GAAP and U.S. GAAP, which affect the Company's consolidated financial statements, are described below.

The following table reconciles the consolidated net income and other comprehensive income as reported under Canadian GAAP with net income and other comprehensive income in accordance with U.S. GAAP:

	2009	2008	2007
Net loss based on Canadian GAAP	\$ (290,287)	\$ (405,865)	\$ (18,526)
Impact on net income of U.S. GAAP adjustments, net of tax:	-	-	-
Net loss based on U.S. GAAP*	\$ (290,287)	\$ (405,865)	\$ (18,526)
	2009	2008	2007
Comprehensive loss based on Canadian GAAP	\$ (290,287)	\$ (405,865)	\$ (18,526)
Change in unrealized gain on securities classified as available-for-sale	-	-	-
Less: related future income taxes	-	-	-
Other comprehensive income adjustments	-	-	-
Total comprehensive loss based on U.S. GAAP	\$ (290,287)	\$ (405,865)	\$ (18,526)
*Basic earnings (loss) per share based on U.S. GAAP net income	\$ (5.39)	\$ (7.35)	\$ (0.33)
*Diluted earnings (loss) per share based on U.S. GAAP net income	\$ (5.39)	\$ (7.35)	\$ (0.33)

The following table reconciles shareholders' equity as reported under Canadian GAAP with shareholders' equity in accordance with U.S. GAAP:

	2009	2008
Shareholders' equity based on Canadian GAAP	\$ 169,339	\$ 453,572
Other comprehensive income	-	-
Cumulative net income impact:		
Other	-	-
Shareholders' equity based on U.S. GAAP	\$ 169,339	\$ 453,572

The consolidated statements are prepared in accordance with Canadian GAAP. As required by the U.S. Securities and Exchange Commission ("SEC"), material differences between Canadian and U.S. GAAP are quantified and described below. Effective January 1, 2007, Canadian GAAP has conformed to U.S. GAAP relating to disclosures of other comprehensive income in the financial statements and accumulated balances of other comprehensive income or loss in the equity section of the Company's consolidated balance sheet. As a result, in the current year there are no reconciling items between Canadian and U.S. GAAP as reported by the Company for 2009. Total cumulative other comprehensive income amounted to \$47,071,000 and \$22,873,000 as at December 31, 2009 and 2008, respectively.

(a) Securities:

Effective January 1, 2007, Canadian GAAP became substantially consistent with U.S. GAAP for the Company's activities relating to the accounting for securities. Under the adoption of these new standards, the Company classified all its investment securities as available-for-sale except for derivative instruments which are classified as held-for-trading, all of which are measured at fair value consistent with U.S. GAAP. Prior to 2007, securities were classified as portfolio investments and were carried at cost or amortized cost, and where a decline in value of an investment is considered to be other than temporary, a write-down of the investment to its estimated recoverable amount is recorded. Under U.S. GAAP, such investments would be classified as available-for-sale and are marked to market after write-downs for other than temporary declines in values, and the unrealized gain or loss, net of any future income taxes, is recorded as other comprehensive income, a component of shareholders' equity.

(b) Income taxes:

On January 1, 2007, the Company adopted, for U.S. GAAP purposes, Financial Accounting Standards Board "(FASB)" interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of an uncertain tax position taken or expected to be taken in a tax return.

FIN 48 uses a two step approach for evaluating tax positions:

- a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized; and

the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized for a position in accordance with the FIN 48 model and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit.

The adoption of FIN 48, had no impact on the opening retained earnings under U.S. GAAP. As of December 31, 2009, the Company had no unrecognized tax benefits. The Company analyzed its tax positions in accordance with the provisions of FIN 48 and has determined that there are no uncertain tax positions. It is difficult to project how unrecognized tax benefits will change over the next 12 months. The Company operates in Canada, the U.S. and other foreign jurisdictions, subject to examination by tax authorities.

(c) Other significant accounting changes:

On July 1, 2009, the FASB Accounting Standards Codification (“ASC”) became the sole source of authoritative GAAP literature recognized by the FASB for financial statements issued for interim and annual periods ending after September 15, 2009. ASC did not change GAAP, but rather combined the sources of GAAP and the framework for selecting among those sources into a single source. Accordingly, the adoption of ASC had no impact on the financial results of the Company.

Prior to the adoption of ASC, the Company adopted various standards which have been codified into ASC. A discussion of these standards, along with a reference to the ASC topics into which they have been codified and the effect of adoption on the Company follows below:

In April 2009, the FASB issued FASB Staff Position (FSP) SFAS No. 115-2 and SFAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (codified into ASC Topic 320, Investments-Debt and Equity Securities). The standard amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. The standard does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. On April 1, 2009, the Company adopted the standard and applied it prospectively. The initial application of the standard had no impact on the Company.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (codified into ASC Topic 820, Fair Value Measurements and Disclosures). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. On January 1, 2008, the Company adopted SFAS No. 157. The initial application of SFAS No. 157 did not have a material effect on the fair values reported by the Company. The additional disclosures required by SFAS No. 157 are presented in Note 5, Fair Value Measurements. In February 2008, the FASB issued FSP SFAS No. 157-2, Effective Date of FASB No. 157 (codified into ASC Topic 820, Fair Value Measurements and Disclosures). FSP SFAS No. 157-2 delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. The initial application of the standard had no impact on the Company.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (codified into ASC Topic 820, Fair Value Measurements and Disclosures). SFAS No. 159 permits the choice of measuring financial instruments and certain other items at fair value. SFAS No. 159 is effective for consolidated financial statements issued for fiscal years beginning after November 15, 2007. On January 1, 2008, the Company adopted SFAS No. 159 and elected not to apply the provisions of SFAS No. 159 to its eligible financial assets and financial liabilities on the date of adoption. Accordingly, the initial application of SFAS No. 159 had no effect on the Company.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (codified into ASC Topic 805, Business Combinations). The standard establishes principles and requirements for how an acquirer recognizes and measures in its consolidated financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree, and recognizes and measures the goodwill acquired in the business combination. The standard also sets forth the disclosures required to be made in the consolidated financial statements to evaluate the nature and financial effects of the business combination. The standard applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. On January 1, 2009, the Company adopted the standard. Accordingly, the standard will be applied by the Company to business combinations occurring on or after January 1, 2009. In April 2009, the FASB issued FSP SFAS No. 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (codified into ASC Topic 805, Business Combinations). The standard amends guidance with respect to the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination.

In March 2008, the FASB issued SFAS No. 161, Disclosure about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (codified into ASC Topic 810, Consolidation). SFAS No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), with the intent to provide users of consolidated financial statements with enhanced understanding of: how and why an entity uses derivative securities; how derivatives and hedges are being accounted for under SFAS No. 133; and how derivatives and hedges affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for consolidated financial statements issued for fiscal years beginning after November 15, 2008. The adoption of this new standard did not have an impact on the Company.

In April 2008, the FASB issued FSP SFAS No. 142-3, Determination of the Useful Life of Intangible Assets (codified into ASC Topic 350, Intangibles-Goodwill and Other). FSP SFAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. Previously, under the provisions of SFAS No. 142, an entity was precluded from using its own assumptions about renewal or extension of an arrangement where there was likely to be a substantial cost or material modifications. FSP SFAS No. 142-3 removes the requirement of SFAS No. 142 for an entity to consider whether an intangible asset can be renewed without substantial cost or material modification to the existing terms and conditions and requires an entity to consider its own experience in renewing similar arrangements. FSP SFAS No. 142-3 also increases the disclosure requirements for a recognized intangible asset to enable a user of consolidated financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent or ability to renew or extend the arrangement. FSP SFAS No. 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. The guidance for determining the useful life of a recognized intangible asset is applied prospectively to intangible assets acquired after the effective date. Accordingly, the initial application of FSP SFAS No. 142-3 had no impact on the Company.

In April 2009, the FASB issued FSP SFAS No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That are not Orderly (codified into ASC Topic 820, Fair Value Measurements and Disclosures). FSP SFAS No. 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, when the volume and level of activity for the asset or liability have significantly decreased. FSP SFAS No. 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP SFAS No. 157-4 is effective for periods ending after June 15, 2009. The Company is currently evaluating the impact of FSP SFAS No. 157-4.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (codified into ASC Topic 855, Subsequent Events), which provides guidance on management's accounting for and disclosure of events that occur after the balance sheet date, but before the financial statements are issued or are available to be issued. The standard is effective for interim or annual financial periods ending after June 15, 2009. The initial application of the standard had no impact on the financial results of the Company.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets, a grandfathered standard under ASC. The standard provides the guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. The standard must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, and for interim periods within that first annual reporting period. The Company does not anticipate that the adoption of the standard will have a material impact on the Company.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), a grandfathered standard under ASC, to amend the consolidation guidance that applies to variable interest entities. The standard is effective for the Company beginning in 2010. The Company does not anticipate that the adoption of the standard will have a material impact on the Company.

On January 21, 2010, the FASB issued FASB Accounting Standards Update (ASU) 2010-06, Improving Disclosures about Fair Value Measurements. The standard amends ASC Topic 820, Fair Value Measurements and Disclosures to require additional disclosures related to transfers between levels in the hierarchy of fair value measurements. The standard is effective for interim and annual reporting periods beginning after December 15, 2009. The standard does

not change how fair values are measured. Accordingly, the standard will not have an impact on the Company.

(d) Future accounting pronouncements:

In February 2008, the AcSB confirmed that a profit oriented publicly accountable enterprise will be required to adopt IFRS. IFRS will replace current Canadian GAAP for those enterprises. For the company, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of the comparative figures.

As the Securities and Exchange Commission allows foreign private issuers to file financial statements using IFRS as published by the IASB, without reconciliation to U.S. GAAP, on adoption of IFRS effective January 1, 2011, the Company will not prepare the above reconciliation.

NOTE CONTRACTUAL OBLIGATIONS:

22

On June 29, 2009, Kingsway and Lincoln entered into a consulting agreement with an external run-off manager to provide certain consulting services relating to Lincoln, including advice and assistance in the development of a Run-off Plan. In addition to base compensation of \$1.3 million annually, the agreement provides for a minimum of \$2.5 million to be paid to the run-off manager at the termination of the contract (provided the contract is not terminated for cause), which, at the latest will be March 1, 2014. As a result of the October 19, 2009 disposition of Walshire and Lincoln, the Company has accrued \$2.5 million for the minimum and an additional \$3.4 million relating to the annual service contract for a total compensation of \$5.9 million as at December 31, 2009.

In addition, the Company has guaranteed the portion of the management fees payable by Lincoln to the run-off manager. See Note 19(a) and (d) for additional details.

NOTE RELATED PARTY TRANSACTION:

23

Related party transactions, including services provided to or received by the Company's subsidiaries, are carried out in the normal course of operations and are measured at the amount of consideration paid or received as established and agreed by the parties. Management believes that consideration paid for such services approximate fair value.

In March 2009, the Company obtained a \$20 million financing facility from AP Assurance to allow for specific capital initiatives. Two of the members of the Company's Board of Directors also sit on the board of AP Assurance making it a related party. The facility was at fair market terms and conditions. As at September 30, 2009, the facility was undrawn, expired and has been terminated. In the fourth quarter of 2009, a new facility has been obtained from the same related party. This new facility is at fair market terms and conditions. No funds were ever drawn on this facility and it was withdrawn subsequent to year end, on February 25, 2010.

Approximately 45% of the KLROC Units acquired through the KLROC Offer were from a related party. See Note 7 for details on the KLROC Offering. The Company issued \$3.5 million for these tendered KLROC units. The terms and conditions for the transaction were identical for all unitholders.

The Company has engaged the services of a company owned by a former director and paid \$1.0 million during the year. Subsequent to the December 31, 2009, the Company purchased the assets of this company as described in the Note 27 (a).

In addition to a previously agreed retainer of C\$0.1 million, the Board of Directors has decided to pay an additional \$0.4 million and C\$0.1 million to the Chairman of the Board. Of these amounts, the Company has paid \$0.2 million and C\$0.1 million during the year.

NOTE RESTRUCTURING CHARGES:

24

In February 2009, the Company announced a corporate restructuring plan to concentrate on its core lines of business and to improve the Company's financial stability. The Company has consolidated operations in the U.S. and Canada, simplified the management structure, reduced costs through synergies and operational efficiencies and positioned the

Company to seize competitive advantage. As the Company exited businesses and streamlined operations, a significant number of employees have been removed from the total workforce. Restructuring costs were expected to be approximately \$20.0 million, to be incurred over fiscal 2009 and 2010. This targeted amount included costs related to discontinued operations. In 2009, the company has expensed \$14.8 million of restructuring costs. Due to the disposition of Walshire and the sale of Jevco, as described in Note 4, some of the planned restructuring costs were incurred in discontinued operations and therefore are not included in the \$14.8 million expense. The expected costs associated with the corporate restructuring plan for continuing operations has been revised to \$18.0 million.

In 2009, restructuring charges for continuing operations were as follows:

	Restructuring charges		
	Severance and Consulting benefits	expense	Total
Provision balance at January 1, 2009	\$-	\$-	\$-
(Income) expense	6,761	8,022	14,783
Payments	3,238	8,022	11,260
Provision balance at December 31, 2009	\$3,523	\$-	\$3,523

The following table summarizes the total restructuring charges incurred by segment during 2009 for continuing operations:

	U.S.	Run-off	Corporate	Total
Total continuing restructuring costs	\$2,237	\$398	\$12,148	\$14,783

The following table summarizes the total amount of costs expected to be incurred for each reporting segment over the span of the restructuring plan:

	U.S.	Run-off	Corporate	Total
Total expected costs for restructuring plan	\$4,500	\$500	\$13,000	\$18,000

As a result of the implementation of the restructuring plan being ahead of target, the total restructuring costs for 2009 represent a significant portion of the total expected costs over the span of the restructuring plan.

NOTE COMPARATIVE FIGURES:

25

Certain comparative figures have been re-classified to conform to the financial statement presentation adopted in the current year.

NOTE SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION:

26

In 2004, KAI issued \$125 million 7.5% senior notes due in 2014 through a private offering. These notes are redeemable at KAI's option on or after February 1, 2009 and are fully and unconditionally guaranteed by the Company. On July 10, 2007, the Company through its newly formed wholly-owned subsidiary Kingsway 2007 General Partnership ("K2007GP") issued C\$100 million 6% senior unsecured debentures with a maturity date of July 11, 2012, unconditionally guaranteed by Kingsway Financial Services Inc. ("KFSI") and KAI, another wholly-owned subsidiary (each a "Guarantor"). The debentures will be redeemable, in whole or part, at the option of K2007GP and are not subject to repayment by the holders prior to maturity. Interest on the debentures is payable semi-annually in arrears in equal installments on January 10 and July 10 each year beginning January 10, 2008. The following tables show condensed consolidating financial information for the Company as of December 31, 2009 and 2008 and for the three years ended December 31, 2009, 2008 and 2007, with a separate column for each Guarantor, the issuer and the other businesses of the Company combined ("Non-Guarantor subsidiaries").

Condensed Consolidating Statement
of OperationsFor the year ended December 31,
2009

	KFSI	KAI	K2007GP	Other subsidiaries	Consolidation adjustments	Total
	(a	(an “Issuer”	(an	(the “Non-		
	“Guarantor”)	and a	“Issuer”)	Guarantor		
	“Guarantor”)	“Guarantor”)	“Issuer”)	subsidiaries”)		
Revenue:						
Net premiums earned	\$ -	\$ -	\$ -	\$ 430,221	\$ -	\$430,221
Investment related income (loss)	(13,829)	9,213	4,283	13,309	-	12,976
Management fees	33,522	16,456	-	-	(49,978)	-
	19,693	25,669	4,283	443,530	(49,978)	443,197
Expenses:						
Claims incurred	-	-	-	355,905	-	355,905
Commissions and premium taxes	-	-	-	73,714	-	73,714
Other expenses	75,599	29,479	392	80,425	(49,978)	135,917
Interest expense	-	26,180	5,060	(7,328)	-	23,912
	75,599	55,659	5,452	502,716	(49,978)	589,448
Loss before unusual items and income taxes	(55,906)	(29,990)	(1,169)	(59,186)	-	(146,251)
Gain on buy back of senior notes	-	3,517	5,984	-	-	9,501
Income (loss) before income taxes	(55,906)	(26,473)	4,815	(59,186)	-	(136,750)
Income taxes (recovery)	(15,388)	-	1,689	(16,711)	-	(30,410)
Equity in undistributed net income of subsidiaries	(65,822)	(54,257)	-	-	120,079	-
Income (loss) from continuing operations	(106,340)	(80,730)	3,126	(42,475)	120,079	(106,340)
Loss from discontinued operations	(186,132)	-	-	-	-	(186,132)
Gain on disposal of discontinued operations	2,185	-	-	-	-	2,185
Net income (loss)	\$ (290,287)	\$ (80,730)	\$ 3,126	\$ (42,475)	\$ 120,079	\$ (290,287)

Condensed Consolidating Statement of
Operations

For the year ended December 31,
2008

	KFSI (a "Guarantor")	KAI (an "Issuer" and a "Guarantor")	K2007GP (an "Issuer")	Other subsidiaries (the "Non- Guarantor subsidiaries")	Consolidation adjustments	Total
Revenue:						
Net premiums earned	\$ -	\$ -	\$ -	\$ 524,816	\$ -	\$ 524,816
Investment related income	485	2,999	6,953	13,672	-	24,109
Management fees	72,028	19,829	-	-	(91,857)	-
	72,513	22,828	6,953	538,488	(91,857)	548,925
Expenses:						
Claims incurred	-	-	-	372,682	-	372,682
Commissions and premium taxes	-	-	-	85,997	-	85,997
Other expenses	89,205	28,920	237	143,533	(91,857)	170,038
Interest expense	3,928	28,240	6,195	(3,341)	-	35,022
	93,133	57,160	6,432	598,871	(91,857)	663,739
Income (loss) before unusual items and income taxes	(20,620)	(34,332)	521	(60,383)	-	(114,814)
Gain on buy back of senior notes	-	652	-	-	-	652
Income (loss) before taxes	(20,620)	(33,680)	521	(60,383)	-	(114,162)
Income taxes (recovery)	(14,788)	(15,998)	177	59,214	-	28,605
Equity in undistributed net income of subsidiaries	(136,935)	(131,341)	-	-	268,276	-
Income (loss) from continuing operations	(142,767)	(149,023)	344	(119,597)	268,276	(142,767)
Loss from discontinued operations	(297,597)	-	-	-	-	(297,597)
Gain on disposal of discontinued operations	34,499	-	-	-	-	34,499
Net income (loss)	\$ (405,865)	\$ (149,023)	\$ 344	\$ (119,597)	\$ 268,276	\$ (405,865)

Condensed Consolidating Statement
of Operations

For the year ended December 31,
2007

	KFSI (a "Guarantor")	KAI (an "Issuer" and a "Guarantor")	K2007GP (an "Non-Guarantor" "Issuer")	Other subsidiaries (the subsidiaries")	Consolidation adjustments	Total
Revenue:						
Net premiums earned	\$ -	\$ -	\$ -	\$ 500,101	\$ -	\$ 500,101
Investment related income (loss)	(1,391)	4,860	6,199	34,782	-	44,450
Management fees	65,924	13,512	-	-	(79,436)	-
	64,533	18,372	6,199	534,883	(79,436)	544,551
Expenses:						
Claims incurred	-	-	-	357,132	-	357,132
Commissions and premium taxes	-	-	-	89,865	-	89,865
Other expenses	87,099	21,409	94	75,746	(79,436)	104,912
Interest expense	8,605	26,540	2,994	729	-	38,868
	95,704	47,949	3,088	523,472	(79,436)	590,777
Income (loss) before income taxes	(31,171)	(29,577)	3,111	11,411	-	(46,226)
Income taxes (recovery)	6,079	(9,802)	1,058	(1,568)	-	(4,233)
Equity in undistributed net income of subsidiaries	(4,743)	(17,532)	-	-	22,275	-
Income (loss) from continuing operations	(41,993)	(37,307)	2,053	12,979	22,275	(41,993)
Income from discontinued operations	23,467	-	-	-	-	23,467
Net income (loss)	\$ (18,526)	\$ (37,307)	\$ 2,053	\$ 12,979	\$ 22,275	\$ (18,526)

Condensed Consolidating
Balance Sheets

As at December 31, 2009	KFSI (a “Guarantor”)	KAI and a “Guarantor”)	K2007GP (an “Issuer” “Issuer”)	Other subsidiaries (the “Non-Guarantor subsidiaries”)	Consolidation adjustments	Total
Assets						
Investments in subsidiaries	\$ 149,147	\$ 350,903	\$ -	\$ (1,188,296)	\$ 688,246	-
	12,467					
Cash	12,467	12,545	1,376	32,338	-	58,726
Investments	-	-	-	522,773	(10,576)	512,197
Goodwill and other intangible assets	-	-	-	37,573	-	37,573
Other assets	10,066	256,282	97,157	(714,968)	554,841	203,378
Assets held for sale	-	-	-	1,145,481	-	1,145,481
	\$ 171,680	\$ 619,730	\$ 98,533	\$ (165,099)	\$ 1,232,511	\$ 1,957,355
Liabilities and Shareholders’ Equity						
Liabilities:						
Notes Payable	\$ -	\$ 215,688	\$ -	\$ (166,499)	\$ 17,033	\$ 66,222
Other liabilities	2,342	21,520	2,275	42,388	(7,484)	61,041
Unearned premiums	-	-	-	120,657	-	120,657
Unpaid claims	-	-	-	361,936	6,565	368,501
Senior unsecured debentures	-	117,975	79,156	(3,488)	(16,879)	176,764
Subordinated indebtedness	-	90,500	-	-	(3,085)	87,415
Liabilities held for sale				907,416	-	907,416
	2,342	445,683	81,431	1,262,410	(3,850)	1,788,016
Shareholders’ equity:						
Share capital	295,291	541,967	14,867	1,515,276	(2,072,110)	295,291
Contributed surplus	20,549	-	-	-	-	20,549
Retained earnings	(193,572)	(367,920)	5,522	(2,966,589)	3,328,987	(193,572)
Accumulated other comprehensive income	47,070	-	(3,287)	23,804	(20,516)	47,071
	169,338					