

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

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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.

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(Exact name of Registrant as specified in its charter)

Ontario (Province or Other Jurisdiction of Incorporation or Organization)	6331 (Primary Standard Industrial Classification Code Number)	Not Applicable (I.R.S. Employer Identification Number, if applicable)
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7120 Hurontario Street, Suite 800, Mississauga, Ontario, Canada L5W 0A9  
(905) 677-8889

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(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

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(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.

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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:

x Annual information form      x 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 o                      82-\_\_\_\_\_                      No x

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 x                      No o

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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

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ANNUAL INFORMATION FORM  
FOR THE YEAR ENDED DECEMBER 31, 2009

KINGSWAY FINANCIAL SERVICES INC.

March 31, 2010

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## 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](http://www.sedar.com), and on the EDGAR section of the U.S. Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov) or through the Company's website at [www.kingsway-financial.com](http://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](http://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 KFCSI'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.

## 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
<b>Total:</b>	<b>C\$4,673,738</b>	<b>C\$5,085,000</b>

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](http://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

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## 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
<b>Assets</b>		
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
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
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
<b>Shareholders' equity:</b>		
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
<b>Share capital</b>			
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
<b>Contributed surplus</b>			
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
<b>Retained earnings (deficit)</b>			
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
<b>Accumulated other comprehensive income</b>			
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
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