KINGSWAY FINANCIAL SERVICES INC
Form 40-F
March 27, 2009

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 40-F

[Check one]

o Registration Statement pursuant to Section 12 of the Securities Exchange Act of 1934
or
x Annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended: December 31, 2008 Commission File Number: 1-15212

KINGSWAY FINANCIAL SERVICES INC.

(Exact name of registrant as specified in its charter)

Ontario	6331	Not Applicable
(Province or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number, if applicable)

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

(Address and telephone number of registrants principal executive offices)

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

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

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

Title of each class	Name of each exchange on which registered
Common Shares, no par value	New York Stock Exchange, Inc.

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

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

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

x Annual Information Form x Audited Annual Financial Statements

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

55,068,528 Common Shares, no par value, outstanding as of December 31, 2008

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- o 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

KINGSWAY FINANCIAL SERVICES INC.

DOCUMENTS FILED UNDER COVER OF THIS FORM

ANNUAL INFORMATION FORM

FOR THE YEAR ENDED DECEMBER 31, 2008

KINGSWAY FINANCIAL SERVICES INC.

March 27, 2009

CURRENCY AND OTHER INFORMATION

Information in this Annual Information Form is as of December 31, 2008, unless otherwise specified. All of the dollar amounts in this Annual Information Form 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 Annual Information Form contain written forward-looking statements. 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. Forward-looking statements are typically identified by words such as "believe", "expect", "may" and "could". By their very nature, these statements are subject to inherent risks and uncertainties, general and specific that may cause actual results to differ materially from the expectations expressed in the forward-looking statements. The Company does not undertake to update any forward-looking statements that may be in this Annual Information Form.

1. CORPORATE STRUCTURE

Incorporation

KFSI was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. On November 10, 1995, KFSI filed articles of amendment deleting its private company share restrictions, subdividing KFSI's 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, KFSI filed articles of amendment to subdivide the common shares on a two-for-one basis. On April 27, 1998, KFSI filed articles of amendment to subdivide the common shares on a two-for-one basis.

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

Inter-Corporate Relationships

KFSI's material subsidiaries and their inter-corporate relationship with KFSI as of the most recent financial year end are listed and described in Note 5(a) to the consolidated financial statements of KFSI (the "Consolidated Financial Statements") contained in KFSI's 2008 Annual Report (the "2008 Annual Report") which is incorporated herein by reference. The 2008 Annual Report is available on SEDAR at ww.sedar.com. All subsidiaries are 100% owned by the Company, directly or indirectly (except for qualifying shares of Kingsway General Insurance Company ("KGIC") held by directors of the Company in order to satisfy applicable statutory requirements).

2. GENERAL DEVELOPMENT OF THE BUSINESS

KFSI is a holding company which operates through its wholly owned subsidiaries in the property and casualty insurance business. Since its inception in 1986, KGIC has provided property and casualty insurance in specialized lines in Canada, primarily in the automobile insurance market. In 1989, KGIC became a wholly owned subsidiary of KFSI. In 1995, KFSI completed its initial public offering.

KFSI operates through its subsidiaries in Canada and the U.S. At the beginning of 2008, the Company was operating through the following subsidiaries in Canada: KGIC, York Fire & Casualty Insurance Company ("York Fire") (sold in 2008) and Jevco Insurance Company ("Jevco"); and in the U.S.: American Country Insurance Company ("ACIC"), American Service Insurance Company, Inc. ("ASIC"), Lincoln General Insurance Company ("Lincoln General"), Mendota Insurance Company and Mendakota Insurance Company (together, "Mendota"), Southern United Fire Insurance Company ("Southern United"), Hamilton Risk Management ("HRM"), Universal Casualty Company and Zephyr Insurance Company Inc. ("Zephyr"). Kingsway America Inc. ("Kingsway America") is the holdings company for all U.S. subsidiaries.

The Company also owns two wholly-owned reinsurance subsidiaries domiciled in Barbados and Bermuda and two wholly-owned insurance intermediaries in the U.S.: Avalon Risk Management Inc. ("Avalon") and Northeast Alliance Insurance Agency, L.L.C. (formerly known as RPC Insurance Agency, L.L.C.). In 1998, KFSI established Avalon to act as an insurance intermediary for specialty lines such as cargo insurance, surety bonds and other insurance coverage for the logistics industry.

Significant events that have influenced the general development of the business over the last three fiscal years include:

(a) the entering into in June 2006 of a new $175 million unsecured credit facility that was set to mature in June 2009 to replace a C$150 million 364 day revolving credit facility originally entered into in March 2004;

(b) in 2006 significant reserve development started to be experienced at the Company's Lincoln General subsidiary and during 2007 a change in methodology and process was used in estimating future claim liabilities. The reserve development experienced from Lincoln General from the period 2006 to 2008 was approximately $449 million.

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(c) the closing in April 2007 of the acquisition of Mendota for a purchase price of approximately $51.1 million. The purchase of Mendota was financed through a combination of internal sources and KFSI's existing credit facilities;

(d) the closing in July 2007 by Kingsway 2007 General Partnership ("Kingsway GP"), a wholly-owned subsidiary of KFSI, of 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;

(e) the redemption in December 2007 of the previously issued C$78 million of 8.25% unsecured senior debentures which had a maturity date of December 31, 2007;

(f) the entering into in December 2007 of a 365 day C$70 million credit facility agreement, which supplements the $175 million that was set to mature in June 2009;

(g) the consolidation in June 2008, of two of the Company's insurance subsidiaries, ACIC and ASIC, to reduce overhead and realize cost savings for the Company.

(h) the repayment in July 2008, of all of the amounts outstanding under the Company's $175 million credit facility that was set to mature in June 2009. 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 on December 2007;

(i) the sale on September 30, 2008, of York Fire, a former subsidiary Company 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;

(j) the consolidation in November 2008, of two of the Company's insurance subsidiaries, Southern United and HRM, to reduce overhead and realize cost savings for the Company; and

(k) in late 2008 the Company engaged Oliver Wyman, international management consultants to develop organizational, expense and claims spend reduction strategies to return the Company to profitability and enhance performance predictability. Cost cutting initiatives are a core part of this strategic plan that has been developed, which the Company has already initiated since the last quarter of 2008.

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 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 include trucking insurance, commercial automobile insurance, commercial and personal property coverages, standard automobile insurance, motorcycle insurance and other specialty lines.

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 Management's Discussion and Analysis set out on page 80 of this form.

In 2008, non-standard automobile business was the largest business line for KFSI and accounted for 43% of KFSI's $1.5 billion of gross premiums written ("GPW") (GPW being the total premiums on insurance underwritten before deduction of reinsurance premiums ceded) in 2008.

KFSI is considered to be one of the largest trucking insurers in North America according to data compiled from A.M. Best Company. This line of business comprised 17% of KFSI's GPW in 2008.

KFSI's premium distribution by line and geographic areas is set out on page 64 of this form in Note 19 to the Consolidated Financial Statements.

In addition to revenue derived from premiums earned, KFSI also derives revenue from premium financing and investment income. This revenue amounted to $130.3 million in 2008 as compared to $136.1 million in 2007.

The selected Supplemental Financial Information set out on page 147 of this form 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, 2008.

Employees

As at December 31, 2008, KFSI employed approximately 2,600 personnel, of whom approximately 800 are located in Canada and approximately 1,800 are located in the U.S. None of our employees are represented by a labour union. The Company believes its relationship with its employees is good and the Company has never experienced a work stoppage.

Liquidity

Capital required for KFSI's business has been obtained from KFSI's public offerings of common shares and debt securities, its syndicated term and operating lending facilities, the issuance of trust preferred securities, internally generated net income and the sale of non-core business lines. KFSI's operations create liquidity by collecting and investing premiums from policyholders. A full discussion is included on page 110 to 115 of this form.

Investment Portfolio

The fair value of KFSI's securities portfolio including cash decreased 28% to $2.5 billion as at December 31, 2008 from $3.5 billion as at December 31, 2007. Total returns on a pre-tax basis were (0.3%) for the year compared with 6.1% for 2007. The investment portfolio as at December 31, 2008 and December 31, 2007 is comprised of assets from a number of different classes as reflected in Note 7 to the Consolidated Financial Statements set out on pages 42 to 45 of this form.

Competitive Position

The insurance industry is price competitive in all markets in which KFSI's insurance subsidiaries operate. KFSI'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. Through deliberate underwriting, pricing, risk selection, claims management, and non-renewal of unprofitable policies, KFSI has produced an underwriting profit in 14 of the last 19 years.

During 2008, KFSI decreased its GPW 19% to $1.50 billion compared to $1.85 billion in 2007. The decreases came primarily from the impact of terminations of unprofitable or non-core business programs and the continuing soft market conditions for the trucking business in the U.S. In certain segments of the insurance market, KFSI noticed a continued softening of the market and wrote reduced premium volumes. KFSI believes that it is better to write less business with higher profits than to compete with other insurers at lower premiums to increase volume at the expense of higher combined ratios. In 2008, Kingsway's combined ratio from Canadian and U.S. Operations was 108.4% and 119.6%, respectively, compared with the industry averages of 102.5% and 104.7%, respectively.

Risk Factors

The risk factors faced by KFSI are described on pages 120 to 130 of this form. The discussion of factors under the section entitled "Risk Factors" 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$0.30 per share, C$0.30 per share and C$0.26 per share for the fiscal years ended December 31, 2008, 2007 and 2006, respectively. KFSI has declared a quarterly dividend of C$0.02 per share payable on March 31, 2009. 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 of Directors of KFSI 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, as of March 16, 2009, 55,068,528 common shares were outstanding. All common shares have the same attributes, including the right to one vote per share.

On November 9, 2006, KFSI announced its intention to commence a normal course issuer bid ("NCIB") to repurchase up to 2,800,000 common shares, ending no later than November 8, 2007 and being no more than five percent of the total number of common shares outstanding. During this period, 563,600 common shares were repurchased at an average price of C$23.01. On November 9, 2007, KFSI announced its intention to commence another NCIB to repurchase up to 2,780,000 common shares, ending no later than November 12, 2008 and being no more than 5% 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 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 March 16, 2009, the Company did not repurchase any common shares.

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.

In addition, Jevco is a federal property and casualty insurance company continued under the Insurance Companies Act (Canada) (the "ICA"), and licensed to carry on property and casualty insurance business in all of the provinces and territories of Canada. The ICA is administered, and activities of Jevco are supervised, by the Office of the Superintendent of Financial Institutions (the "OSFI"). Under the ICA, advance approval by the OSFI is required prior to the acquisition of a significant interest in an insurance company licensed thereunder. A "significant interest" is generally a direct or indirect ownership interest representing 10% of the voting rights or 25% of the shareholders' equity of an insurance company.

Debt Securities

Kingsway America, a subsidiary of KFSI, has issued $125 million 7.50% senior notes due in 2014. The notes are fully and unconditionally guaranteed by KFSI. The notes are redeemable at Kingsway America's option commencing February 1, 2009.

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.

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

In July 2007, Kingsway GP, a subsidiary of KFSI, issued C$100 million principal amount of senior unsecured debentures. These debentures bear interest at the rate of 6% per annum and mature on July 11, 2012.

Ratings

The ratings received from rating organizations for securities of KFSI are described on page 39 to 40 of the 2008 Annual Report and this 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:

	TSX			NYSE		
2008	High (C$)	Low (C$)	Volume	High (US$)	Low (US$)	Volume
January	12.93	10.73	7,870,382	12.91	10.40	770,700
February	13.76	11.56	3,146,396	13.69	11.46	309,500
March	13.27	10.20	2,547,371	13.40	9.99	203,900
April	14.18	11.61	2,696,227	14.00	11.37	259,100
May	14.99	9.52	9,698,001	14.83	9.59	573,600
June	9.65	8.00	4,880,357	9.63	7.84	313,800
July	9.17	6.84	5,889,275	9.04	6.77	430,300
August	9.5	6.91	3,780,548	9.13	6.69	1,075,900
September	9.88	6.85	4,123,374	9.23	6.44	1,113,000
October	7.84	4.95	5,121,420	8.49	4.42	3,351,400
November	8.86	4.75	4,723,532	8.39	3.70	2,108,500
December	6.77	4.86	2,862,263	5.58	3.95	1,005,600

7. DIRECTORS AND EXECUTIVE OFFICERS

Name, Occupation and Security Holdings

The following table and the notes thereto states the names of all 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 March 16, 2009. The same information relating to the Directors of the Company is contained in the "Election of Directors" section of the Management Information Circular of KFSI dated March 16, 2009 (the "2009 Management Information Circular"), which section is incorporated herein by reference. The 2009 Management Information Circular is available on SEDAR at www.sedar.com.

Name and Municipality of Residence	Position with the Company	Common Shares of the Company beneficially owned, directly or indirectly, or controlled or directed	Number of Options Held
W. Shaun Jackson, Oakville, ON	President and Chief Executive Officer, KFSI	120,929	361,000
Shelly Gobin Mississauga, ON	Senior Vice President and Chief Financial Officer, KFSI	82,784	50,000
Frank Amodeo Toronto, ON	Vice President, KFSI and Chief Operating Officer, Lincoln General	9,204	42,500
Denis Cloutier Newmarket, ON	Vice President and Chief Actuary, Canadian Operations, KFSI	2,194	28,500
Leslie DiMaggio Mobile, Alabama, United States of America	Vice President, Operational Effectiveness, KFSI	Nil	24,167
Dennis Fielding Pickering, ON	Senior Vice President and Chief Administration Officer, KFSI	8,229	70,500
Kathleen Howie Oakville, ON	Vice President and General Counsel, KFSI	1,661	20,000
Tom Mallozzi Brampton, ON	Vice President, Underwriting, KFSI	837	18,500
Glenn Penny Oakville, ON	Vice President, Claims, KFSI	Nil	23,000
Anastassia Plitman Maple, ON	Vice President, Corporate Internal Audit, KFSI	734	12,000
Colin Simpson Toronto, ON	Senior Vice President and Chief Operating Officer, KFSI	7,830	102,500
Andrew Wright Toronto, ON	Vice President, Reinsurance and Risk Management, KFSI	2,739	28,000

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.

- W. Shaun Jackson was appointed as the President and Chief Executive Officer of KFSI effective January 1, 2008. Prior thereto he served as the Executive Vice President and Chief Financial Officer of KFSI.

• Shelly Gobin was appointed as the Senior Vice President and Chief Financial Officer of KFSI on May 8, 2008. Ms. Gobin was appointed Vice President and Chief Financial Officer of KFSI effective January 1, 2008. Prior thereto she was the Vice President and Treasurer of KFSI.

• 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

• Kathleen Howie joined KFSI in December 2007. Prior thereto, Ms. Howie was formally in 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. From August 2003 to August 2004, Ms. Howie was a Special Associate at Blaney McMurty LLP. Prior to moving in-house Ms. Howie practiced privately for insurers in a variety of complex commercial matters.

• Tom Mallozzi joined KFSI in December 2005. Prior thereto, Mr. Mallozzi was with Kingsway General as Vice President, Personal Lines from January 2003 until December 2005. From November 1998 to December 2002 Mr. Mallozzi was Manager, Personal Lines with Allianz Insurance Company.

• Glenn Penny jointed 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. He has also served as a Senior Claim Executive with the Canadian operations of Progressive Casualty Insurance Company , a North American non-standard automobile insurance company from 1994 to 1997.

• 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. From September 1998 to January 2005, Ms. Plitman was the Director of Internal Audit for Nortel Networks.

• Colin Simpson was appointed as the Senior Vice President and Chief Operating Officer of the Company on February 9, 2009. From May 8, 2008 to February 8, 2009, Mr. Simpson served as the Senior Vice President and Chief Strategy Officer of the Company. Prior thereto, Mr. Simpson held a variety of senior positions with York Fire culminating in his appointment as the President and Chief Executive Officer of York Fire in July, 2007, a position he held until May 8, 2008.

• Andrew Wright joined KFSI in July 2004. Prior thereto, Mr. Wright was Senior Reinsurance Underwriter at Aviva Canada Inc. from April 2002 to July 2004. From October 2000 to April 2002, Mr. Wright was a consultant and teaching advisor for the Insurance Institute of Canada.

As a group, the directors and officers of KFSI own, directly or indirectly or exercise control or direction over 409,751 (0.74%) of the total outstanding common shares of KFSI as of March 16, 2009. 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.

The Company does not have an Executive Committee. In 2008, F. Michael Walsh served as KFSI's Lead Director until May 7, 2008. On May 8, 2008, Mr. Walsh was appointed Chair of the Company. On January 13, 2009, Mr. Walsh resigned as Chair and David H. Atkins was appointed as the Chair. Mr. Atkins is not standing for re-election as a director of the Company at the Company's Annual Meeting of Shareholders to be held on April 23, 2009.

Committees of the Board of Directors

2008 Committees of the Board of Directors

The Board of Directors (the "Board") has established an Audit Committee comprised solely of outside Directors. Information concerning the Audit Committee can be found in the Section entitled "Audit Committee Information" in this Annual Information Form.

In 2008, the Board had three other standing committees in addition to the Audit Committee: (a) a Nominating Committee which in 2008 was comprised of F. Michael Walsh (Chair), David H. Atkins, J. Brian Reeve and John F. (Jack) Sullivan; (b) a Compensation and Management Resources Committee which in 2008 was comprised of Walter E. Farnam (Chair), Thomas Di Giacomo, John L. Beamish and Robert T.E. Gillespie; and (c) an Investment Committee which in 2008 was comprised of Thomas Di Giacomo (Chair), F. Michael Walsh, John F. (Jack) Sullivan and W. Shaun Jackson.

Changes to the Committees in 2009

With respect to the Compensation and Management Resources Committee, on January 8, 2009, Mr. Beamish resigned as a member of the Compensation and Management Resources Committee. On February 9, 2009, Mr. Gillespie resigned as a member of the Compensation and Management Resources Committee and on February 19, 2009, Mr. Di Giacomo resigned as a member of the Compensation and Management Resources Committee. On February 19, 2009, J. Brian Reeve and Spencer L. Schneider were appointed to the Committee.

On February 10, 2009, Mr. Walsh resigned as a member of the Nominating Committee and Spencer L. Schneider was appointed in his place. On March 6, 2009, Mr. Atkins resigned as a member of the Nominating Committee.

With respect to the Investment Committee, on January 7, 2009 Mr. Jackson resigned as a member of the Investment Committee.

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:

(a) is, as at the date of this Annual Information Form, or was within 10 years before the date of this Annual Information Form, a director, chief executive officer or chief financial officer of any company (including KFSI), that:

(i) was subject to 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

(ii) 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:

(b) is, as at the date of this Annual Information Form, or has been within the 10 years before the date of this Annual Information Form, a director or executive officer of any company (including KFSI) that:

(i) 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

(ii) 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:

(c) 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

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, had or is expected to have any material direct or indirect transactions with the Company that materially affected or would materially affect the Company.

The Audit Committee reviewed all related party transactions between KFSI and its subsidiaries and the officers and directors of KFSI. The Audit Committee determined that there were no related party transactions that required disclosure under any securities laws other than (i) legal services rendered by Cassels Brock & Blackwell LLP, a law firm. J. Brian Reeve, a director of the Company, is a partner of such firm; and (ii) legal services rendered by Fogler, Rubinoff LLP, a law firm. Michael S. Slan, the Secretary of the Company, is a partner of such firm.

10. AUDIT COMMITTEE INFORMATION

Composition of the Audit Committee for 2008

During the fiscal year ended December 31, 2008, the Audit Committee of KFSI was composed of the following four members: David H. Atkins (Chair), Thomas A. Di Giacomo, Walter E. Farnam and F. Michael Walsh. 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 I to this Annual Information Form.

The Board believes that in 2008, the composition of the Audit Committee reflected a high level of financial literacy and expertise. Each member of the Audit Committee during 2008 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. In addition, the Board has determined that Mr. Atkins is an "Audit Committee Financial Expert" as such term is defined under United States securities laws. 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 Committee in 2008 that is relevant to the performance of his responsibilities as a member of the Audit Committee in 2008:

David H. Atkins is an independent consultant. He previously was a Senior Advisor to Lang Michener LLP, a law firm, from 1999 to 2007. He is a fellow of the Institute of Chartered Accountants of Ontario. Mr. Atkins consults to the insurance and other industries regarding business strategy, mergers, acquisitions, governance and financial reporting. He also advises with regard to regulatory compliance. Mr. Atkins has lectured extensively with respect to governance and audit committee issues. Mr. Atkins is Chairman for the Swiss Reinsurance group in Canada and also sits on the board of several Swiss Reinsurance subsidiaries in the United States and Canada, as well as serving on the boards of several other companies including Pareto Corporation, Pethealth Inc., Nightingale Informatix Inc. and Integrated Asset Management Inc.

Thomas A. Di Giacomo has been the President of Tadico Limited, a business consulting and investment firm since 1994. Prior thereto he held a number of positions at Manulife Financial, the most recent being Chairman of the Board, President and CEO from 1990-1993. Mr. Di Giacomo is the Chairman of RDM Corporation and is a member of the St. Michael's College Foundation of the University of Toronto and past chairman of Kids Help Phone - a Canadian charity that provides national, bilingual confidential phone and web counselling, referral and information services for children and youth. Mr. Di Giacomo sits or has sat on the Board of several companies including Cinram International Income Fund, Xceed Mortgage Corporation, and Menu Foods Income Fund.

Walter E. Farnam received a B.A. from Brown University. During his career, Mr. Farnam has held various senior positions in the insurance industry and from 1998 until his retirement in June 2001 served as Chairman of the Board of the CGU Insurance Group in the United States. Prior to June 1998, Mr. Farnam was Chairman and Chief Executive Officer of General Accident Insurance in Philadelphia. He also held the position of President and Chief Operating Officer of General Accident Insurance in the United States from July 1985 through August 1991. He is a Fellow of the Casualty Actuarial Society and is Past Chairman of the Council of Insurance Company Executives. Mr. Farnam also served on the Executive Committee and Board of Trustees of the American Institute for Chartered Property Casualty Underwriters/Insurance Institute of America. Mr. Farnam is currently the chair of the board of directors of Crozer-Keystone Health System, a not-for-profit organization.

F. Michael Walsh is a retired investment industry executive, who prior to January 2000 was Senior Vice-President, Secretary and a Director of First Marathon Securities Limited (now National Bank Financial) and Vice-President and Secretary of First Marathon Inc. He is a Retired Industry Member of the Ontario District Council of the Investment Dealers Association of Canada and has served as an advisor to the staff of the Ontario Securities Commission and was formerly a member of the Council on Investment Issues of the Conference Board of Canada. He is a Past-chair of the Board of Governors of the University of Guelph and received the Queen's Golden Jubilee Medal in 2003 for excellence in leadership and governance of a postsecondary institution as a volunteer. Mr. Walsh sits on the Board of Neo Material Technologies Inc., a corporation whose shares are listed on the TSX.

Recent Changes to the Composition of the Audit Committee

On February 19, 2009, J. Peter Eccleton and Larry G. Swets, Jr. were appointed to the Audit Committee. The Board determined that each of Messrs. Eccleton and Swets, Jr. are independent. In addition, the Board has determined that each of Messrs. Eccleton and Swets, Jr. meet the financial literacy requirements of MI 52-110 and the NYSE Provisions. The Board determined that each of Mr. Eccleton and Swets, Jr. is an "audit committee financial expert" as contemplated by the NYSE Provisions.

Messrs. Atkins, Di Giacomo, Eccleton and Walsh are not standing for re-election or election, as the case may be, as directors of the Company at the Company's Annual Meeting of Shareholders to be held on April 23, 2009.

Auditors' Fees

Aggregate fees paid to the Company's Auditors during the fiscal years ended December 31, 2008 and 2007 were as follows:

(in Canadian dollars)	2008 Fee Amount	2007 Fee Amount
Audit Fees	$4,549,500	$4,586,000
Audit-related Fees	$136,200	$74,000
Tax Fees	$397,300	$208,000
All Other Fees	$2,000	$2,000
Total:	$5,085,000	$4,870,000

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 of KFSI for the fiscal year ending December 31, 2008 and in regard to the Company's internal control over financial reporting at December 31, 2008. The Canadian Institute of Chartered Accountants gives authority to the reports.

Pierre Laurin, of the Tillinghast insurance consulting business of Towers Perrin Inc., prepared an actuary report in regard to the consolidated financial statements of KFSI for the fiscal year ending December 31, 2008. 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 Perrin Inc. 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. ADDITIONAL INFORMATION

Financial information about the Company is contained in its comparative financial statements and Management's Discussion and Analysis for fiscal year ended December 31, 2008, and additional information relating to the Company is available on SEDAR at www.sedar.com.

Additional information, including directors' and officers' remuneration and indebtedness, the principal holders of KFSI securities and securities authorized for issuance under equity compensation plans, where applicable, is contained in KFSI's Proxy Circular dated as of March 16, 2009 in connection with its Annual Meeting of Shareholders to be held on April 23, 2009, which involves the election of directors.

Copies of the Annual Information Form, as well as copies of the 2008 Annual Report of KFSI for the year ended December 31, 2008 and Proxy Circular dated March 16, 2009 may be obtained from:

Kingsway Financial Services Inc., Secretary
c/o Fogler, Rubinoff LLP
95 Wellington Street West Suite 1200,
Toronto-Dominion Centre
Toronto, Ontario M5J 2Z9

Telephone:416-941-8857
Fax: 416-941-8852

APPENDIX I

Kingsway Financial Services Inc
AUDIT COMMITTEE CHARTER

1. 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 internal audit 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 member 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 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 General 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 and Corporate Secretary 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 Business Conduct and Ethics and a Code of Ethics for the Directors, Chief Executive Officer, Chief Financial Officer and other Senior Financial Personnel 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.

May 2008

Consolidated Financial Statements of

KINGSWAY FINANCIAL SERVICES INC.

As at December 31, 2008 and 2007

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, 2008, 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 of 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, 2008 and has concluded that such internal control over financial reporting is effective as of December 31, 2008.

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.

/s/ W. Shaun Jackson
W. Shaun Jackson
President & Chief Executive Officer

/s/ Shelly Gobin
Shelly Gobin
Senior Vice President & Chief Financial Officer

March 27, 2009

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, 2008, 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, 2008, 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, 2008, we also have conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our report dated March 27, 2009 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Chartered Accountants, Licensed Public Accountants
Toronto, Canada
March 27, 2009

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.

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 the Tillinghast insurance consulting business of Towers Perrin Inc., 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.

/s/ W. Shaun Jackson
W. Shaun Jackson
President & Chief
Executive Officer
March 27, 2009

/s/ Shelly Gobin
Shelly Gobin
Senior Vice President & Chief
Financial Officer

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, 2008 and December 31, 2007 and the related 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, 2008. 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, 2008 and 2007, we also 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 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and December 31, 2007 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008 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 24 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, 2008, 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 27, 2009 expressed an unqualified opinion on the effectiveness of, the Company's internal control over financial reporting.

/s/ KPMG LLP

Chartered Accountants, Licensed Public Accountants
Toronto, Canada
March 27, 2009

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, 2008 and 2007 and their changes in the consolidated statement of operations for each of the years in the three year period ended December 31, 2008 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.

/s/ Pierre Laurin
Pierre Laurin, Towers Perrin Inc.
Fellow Canadian Institute of Actuaries
March 27, 2009

KINGSWAY FINANCIAL SERVICES INC.
CONSOLIDATED BALANCE SHEETS
(In thousands of U.S. dollars)

As at December 31

	2008	2007
Assets		
Cash and cash equivalents	$ 105,656	$ 161,635
Securities (Note 7)	2,370,485	3,256,365
Accrued investment income	24,554	33,186
Financed premiums	61,616	91,851
Accounts receivable and other assets	276,450	365,410
Due from reinsurers and other insurers (Note 15)	177,945	207,137
Deferred policy acquisition costs	127,555	176,202
Income taxes recoverable	14,737	1,348
Future income taxes (Note 16)	25,291	114,066
Capital assets (Note 11)	113,375	133,431
Goodwill and intangible assets (Notes 5(e), 18(a), (b) & 23)	45,777	116,774
	$ 3,343,441	$ 4,657,405
Liabilities and Shareholders' Equity		
Liabilities:		
Bank indebtedness (Note 20(a))	$ -	$ 172,436
Loans payable (Note 20(d))	66,222	66,222
Accounts payable and accrued liabilities	135,565	144,940
Unearned premiums	536,480	758,490
Unpaid claims (Note 17)	1,879,016	2,267,082
Senior unsecured debentures (Note 20(b))	185,203	220,080
Subordinated indebtedness (Note 20(c))	87,383	87,354
	$ 2,889,869	$ 3,716,604
Shareholders' equity:		
Share capital (Note 12)	322,344	326,151
Contributed surplus	9,791	7,619
Retained earnings	98,564	521,165
Accumulated other comprehensive income	22,873	85,866
	453,572	940,801
Contingent liabilities (Note 22)		
	$ 3,343,441	$ 4,657,405

See accompanying notes to consolidated financial statements.

On behalf of the Board:

/s/ Walter E Farnam	/s/ David H. Atkins
Walter E. Farnam	David H. Atkins
Director	Director

KINGSWAY FINANCIAL SERVICES INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands of U.S. dollars, except per share amounts)

Years ended December 31

	2008	2007	2006
Gross premiums written	$ 1,503,191	$ 1,848,718	$ 1,781,018
Net premiums written	$ 1,367,945	$ 1,706,645	$ 1,653,277
Revenue:			
Net premiums earned (Note 15)	$ 1,484,263	$ 1,714,006	$ 1,601,994
Net investment income (Note 7)	130,302	136,139	115,360
Net realized gains (losses) (Note 7)	(138,971)	52,187	28,651
	1,475,594	1,902,332	1,746,005
Expenses:			
Claims incurred (Notes 15 and 17)	1,205,610	1,359,083	1,124,911
Commissions and premium taxes (Note 15)	266,594	307,833	297,024
General and administrative expenses	256,483	227,505	164,876
Interest expense	35,022	38,867	30,247
Amortization of intangible assets	4,887	4,007	1,030
Goodwill impairment (Note 23)	62,876	-	-
	1,831,472	1,937,295	1,618,088
Income (loss) from continuing operations before income taxes	(355,878)	(34,963)	127,917
Income taxes (recovery) (Note 16):			
Current	(18,999)	33,568	30,178
Future	92,373	(37,718)	(15,201)
	73,374	(4,150)	14,977
Income (loss) from continuing operations	$ (429,252)	$ (30,813)	$ 112,940
Income from discontinued operations, net of taxes (Note 6)	23,387	12,287	10,369
Net income (loss)	$ (405,865)	$ (18,526)	$ 123,309
Per share amounts (in dollars) (Note 12):			
(Loss) earnings per share - continuing operations			
Basic	$ (7.78)	$ (0.55)	$ 2.01
Diluted	$ (7.78)	$ (0.55)	$ 1.99
(Loss) earnings per share - net income (loss)			
Basic	$ (7.35)	$ (0.33)	$ 2.19
Diluted	$ (7.35)	$ (0.33)	$ 2.17
Dividends declared per common share (in Canadian dollars)	$ 0.30	$ 0.30	$ 0.26

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands of U.S. dollars)

Years ended December 31

	2008	2007	2006
Share capital			
Balance at beginning of year	$326,151	$328,473	$331,470
Issued during the year	89	1,082	3,004
Repurchased for cancellation	(3,896)	(3,404)	(6,001)
Balance at end of year	322,344	326,151	328,473
Contributed surplus			
Balance at beginning of year	$7,619	$5,352	$3,237
Stock option expense	2,172	2,267	2,115
Balance at end of year	9,791	7,619	5,352
Retained earnings			
Balance at beginning of year	$521,165	$560,126	$460,050
Net income (loss) for the year	(405,865)	(18,526)	123,309
Common share dividends	(15,460)	(15,710)	(12,988)
Repurchase of shares for cancellation	(1,276)	(4,725)	(10,245)
Balance at end of year	98,564	521,165	560,126
Accumulated other comprehensive income			
Balance at beginning of year	$85,866	$7,011	$9,958
Cumulative effect of adopting new accounting policies	-	17,672	-
Other comprehensive income (loss) (Note 5(c))	(62,993)	61,183	(2,947)
Balance at end of year	22,873	85,866	7,011
Total shareholders' equity at end of year	$453,572	$940,801	$900,962

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands of U.S. dollars)

Years ended December 31

	2008	2007	2006
Comprehensive income (loss)			
Net income (loss)	$(405,865)	$(18,526)	$123,309
Other comprehensive income (loss), net of taxes:			
• Change in unrealized gains (losses) on available-for-sale securities:			
Unrealized gains arising during the year, net of income taxes1	14,201	19,885	-
Reclassification to net income (loss) of realized gains, net of income taxes 2	(11,361)	(13,312)	-
• Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	(56,988)	54,610	(2,947)
• Loss on cash flow hedge	(8,845)	-	-
Other comprehensive income (loss)	(62,993)	61,183	(2,947)
Comprehensive income (loss)	$(468,858)	$42,657	$120,362

(1) Net of income tax (recovery) of $(3,827) in 2008, $803 in 2007.

(2) Net of income tax of $5,516 in 2008, $5,100 in 2007.

KINGSWAY FINANCIAL SERVICES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of U.S. dollars)

Years ended December 31

	2008	2007	2006
Cash provided by (used in):			
Operating activities:			
Net income (loss)	$(405,865)	$(18,526)	$123,309
Items not affecting cash:			
Amortization of intangibles and goodwill impairment	67,763	4,007	1,030
Amortization of capital assets and deferred charges	13,369	11,535	6,598
Future income taxes	94,746	(36,271)	(17,362)
Net realized loss (gains)	98,257	(52,111)	(28,987)
Amortization of bond premiums and discounts	(3,612)	(7,951)	(2,667)
	(135,342)	(99,317)	81,921
Change in non-cash balances:			
Deferred policy acquisition costs	54,497	(17,307)	(9,801)
Due from reinsurers and other insurers	223,805	(177,024)	29,266
Unearned premiums	(224,665)	35,918	34,037
Unpaid claims	(401,863)	291,254	95,036
Increase in contributed surplus	2,172	2,267	2,115
Net change in other non-cash balances	18,926	31,295	(65,345)
	(462,470)	67,086	167,229
Financing activities:			
Increase in share capital, net	89	1,082	3,004
Repurchase of common shares for cancellation	(5,172)	(8,129)	(16,246)
Common share dividend	(15,460)	(15,710)	(12,988)
Increase (decrease) in bank indebtedness and loans payable	(175,175)	111,776	40,845
Increase (decrease) in senior unsecured debentures	(17,517)	17,274	-
	(213,235)	106,293	14,615
Investing activities:			
Purchase of securities	(2,980,183)	(4,135,457)	(3,279,985)
Proceeds from sale of securities	3,541,683	4,074,167	3,164,215
Financed premiums receivable, net	18,258	(14,440)	18,369
Acquisitions (Note 18)	(212)	(44,721)	(22,415)
Net proceeds from sale of discontinued operations	44,067	-	-
Additions to capital assets	(3,887)	(20,999)	(43,356)
	619,726	(141,450)	(163,172)
Increase (decrease) in cash position during the year	(55,979)	31,929	18,672
Cash and cash equivalents, beginning of year	161,635	129,706	111,034
Cash and cash equivalents, end of year	$105,656	$161,635	$129,706
Supplementary disclosure of cash information:			
Represented by:			
Cash on hand and balances with banks	100,749	147,478	126,887
Investments with maturities less than 30 days	4,907	14,157	2,819
Cash and cash equivalents, end of year	$105,656	$161,635	$129,706
Cash paid for:			

Interest	$17,767	$36,242	$30,170
Income taxes	4,936	38,894	45,659

See accompanying notes to consolidated financial statements.

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KINGSWAY FINANCIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

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

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KINGSWAY FINANCIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

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

NOTE 1 CHANGE IN ACCOUNTING POLICY:

On January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1535, Capital Disclosures, Section 3862, Financial Instruments - Disclosures and Section 3863, Financial Instruments - Presentation.

Handbook Section 1535 requires the following disclosures: (i) qualitative information about an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity manages as capital; (iii) whether the entity has complied with any externally imposed capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. See Note 9 for additional details.

Handbook Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements but not changing the existing presentation requirements for financial instruments. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Handbook Section 3862 requires qualitative and quantitative disclosure of: (i) exposures to risks arising from financial instruments, how they arose and the potential impact on the amount, timing and certainty of future cash flows; (ii) information about the risk management function and the reporting and measurement systems used; (iii) the entity’s policies for hedging or mitigating risk and avoiding concentrations of risk; and (iv) the sensitivity to individual market risk factors together with the methodology for performing the analysis. Handbook Section 3863 deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. See Note 8 for additional details.

NOTE 2 FUTURE CHANGE IN ACCOUNTING POLICY AND DISCLOSURE:

Effective January 1, 2009, the Company will apply the recommendations of the CICA in Handbook Section 3064, Goodwill and Intangible Assets. This Section will replace Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs, which establish standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets by profit-oriented enterprises. The adoption of this standard is not expected to have a significant impact on the Company’s consolidated financial statements.

NOTE 3 ACCOUNTING CHANGES EFFECTIVE IN 2007:

On January 1, 2007, the Company adopted the CICA’s standards in Handbook Section 3855, Financial Instruments - Recognition and Measurement, Section 3865, Hedges, Section 1530, Comprehensive Income and Section 3251, Equity. As a result, effective January 1, 2007, transition adjustments were made to certain existing financial instruments to adjust their carrying value to market value, to eliminate the recognition of deferred realized gains, and with corresponding adjustments to income taxes, actuarial liabilities, accumulated other comprehensive income and retained earnings.

KINGSWAY FINANCIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

NOTE 4 FUTURE ACCOUNTING CHANGES - INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS"):

In February 2008, the Canadian Accounting Standards Board ("AcSB") confirmed that a profit-oriented publicly accountable enterprise will be required to adopt IFRS. IFRS will replace current Canadian general accepted accounting principles ("GAAP") for those enterprises. For the Company, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. The Company initiated the process of IFRS conversion during the third quarter of 2008. The Company is in its detailed assessment phase, analyzing the impact that the adoption of IFRS will have on its consolidated financial statements.

NOTE 5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition, and divestitures are included up to the date of disposal. Assets and liabilities of the acquired companies are included in the financial statements at their fair values at the date of acquisition. The Company holds interests in variable interest entities that are not included in the consolidated financial statements and which are more fully described in Note 21.

The following is a list of the material subsidiaries, all of which are 100% owned, directly or indirectly, (except for qualifying shares of Kingsway General Insurance Company held by directors in order to satisfy applicable statutory requirements), with the jurisdiction of incorporation indicated in brackets: 7120 Hurontario Limited Partnership (Ontario); American Country Holdings Inc. (Delaware); American Country Insurance Company (Illinois); American Country Financial Services Corp. (Illinois); American Country Underwriting Agency Inc. (Illinois); American Service Investment Corporation (Illinois); American Service Insurance Company, Inc. (Illinois); ARK Insurance Agency Inc. (Illinois); Avalon Risk Management, Inc. (Illinois); Appco Finance Corporation (Florida); Hamilton Risk Management Company (Florida); HI Holdings, Inc. (Hawaii); Insurance Management Services Inc. (Florida); U.S. Security Insurance Company (Florida); Jevco Insurance Company (Canada); Kingsway 2007 General Partnership (Delaware); Kingsway America Inc. (Delaware); Kingsway Finance Nova Scotia, ULC (Nova Scotia); Kingsway General Insurance Company (Ontario); Kingsway Reinsurance (Bermuda) Ltd. (Bermuda); Kingsway Reinsurance Corporation (Barbados); Kingsway U.S. Finance Partnership (Delaware); Kingsway U.S. Tier II Finance Partnership (Delaware); MIC Holdings Inc. (Minnesota); Mendota Insurance Company (Minnesota); Mendakota Insurance Company (Minnesota); Southern United Holding, Inc. (Alabama); Southern United Fire Insurance Company (Alabama); Southern United General Agency of Texas, Inc. (Texas); UCC Corporation (Nevada); Universal Casualty Company (Illinois); Walshire Assurance Company (Pennsylvania); Lincoln General Insurance Company (Pennsylvania); Zephyr Insurance Company (Hawaii); and Northeast Alliance Insurance Agency L.L.C. (formerly RPC Insurance Agency) (Delaware).

(b) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

(c) Securities:

All financial instruments are designated as available-for-sale securities (“AFS”) with the exception of derivative instruments which are classified as held-for-trading securities (“HFT”). AFS securities are carried at fair value and the unrealized gains and losses are included in Accumulated other comprehensive income (“AOCI”) until a sale or other-than-temporary impairment is recognized, at which point cumulative unrealized gains or losses are recorded in the statement of operations. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect other-than-temporary impairments in value are included in “Net realized gains”. HFT securities are carried at fair value and unrealized gains and losses are included in the statement of operations.

Prior to the adoption of the new guidance effective January 1, 2007, fixed term investments were carried at amortized cost providing for the amortization of the discount or premium on a constant yield basis to maturity. Investments in common and preferred shares were carried at cost.

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

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

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

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

(d) Cash and cash equivalents:

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

(e) Goodwill and other intangible assets:

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

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

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

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

(f) Deferred policy acquisition costs:

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

(g) Premium revenue and unearned premiums:

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

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

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

(h) Unpaid claims:

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

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

(i) Reinsurance:

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

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

(j) Translation of foreign currencies:

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

The unrealized foreign currency translation gains and losses arising from available-for-sale financial assets are included in other comprehensive income as unrealized gains/losses on available-for-sale securities until realized, at which time they are reclassified from accumulated other comprehensive income to the Consolidated Statement of Operations. Prior to fiscal 2007, unrealized foreign currency gains or losses relating to monetary investment securities were recorded in net income.

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

(k) Income taxes:

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

(l) Stock-based compensation plan:

The Company has a stock-based compensation plan which is described in Note 13. The Company uses the fair-value method of accounting for stock-based compensation awards granted to employees and non-employee directors for options granted on or after January 1, 2003. The Company determines the fair value of the stock options on their grant date using the Black-Scholes option pricing model and records the fair value as a compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, the amount of proceeds together with the amount recorded in contributed surplus, is recorded in share capital.

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

During 2006 the Company adopted the recommendation of CICA Emerging Issues Committee (“EIC”) 162 Stock-Based Compensation for Employees Eligible to Retire before the Vesting Date that clarifies the issues relating to the compensation cost attributable to a stock-based award for an employee eligible to retire at the grant date and an employee eligible to retire during the vesting period.

(m) Capital assets:

Capital assets are reported in the financial statements at amortized cost. Amortization of capital assets has been provided using the straight-line method over the estimated useful lives of such assets. The useful lives range from 10 to 40 years for buildings, 3 to 39 years for leasehold improvements, 3 to 10 years for furniture and equipment, 3 to 5 years for computers and software and 3 to 5 years for automobiles.

KINGSWAY FINANCIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

NOTE 6 DISCONTINUED OPERATIONS:

On September 30, 2008 the Company completed its previously announced sale of York Fire & Casualty Insurance Company ("York Fire"), a primarily standard insurance writer, for C$95 million in cash. The Company has classified York Fire as discontinued operations and the results of its operations are reported separately for all periods presented. Prior to the sale, York Fire was part of the Canadian Reporting Segment.

Summarized financial information for discontinued York Fire operations is shown below.

Years ended December 31

	2008	2007	2006
Operations:			
Revenue	80,364	133,353	170,350
Income (loss) from discontinued operations before income taxes	(16,115)	13,552	11,937
Income tax (recovery)	(5,003)	1,265	1,568
Income (loss) from discontinued operations before disposal, net of taxes	(11,112)	12,287	10,369
Disposals:			
Gain on disposal before income taxes	41,411	-	-
Income tax	6,912	-	-
Gain on disposal, net of taxes	34,499	-	-
Total income from discontinued operations, net of taxes	23,387	12,287	10,369

Assets and liabilities include the following assets and liabilities of York Fire:

As at December 31

	2008	2007
Assets		
Cash and cash equivalents	$ -	$ 849
Securities	-	65,209
Financed premiums	-	34,088
Due from reinsurers and other insurers	-	51,984
Deferred policy acquisition costs	-	7,447
Income taxes recoverable	-	3,160
Future income taxes	-	3,226
Capital assets	-	142
Other assets	-	6,786
Assets of discontinued operations	$ -	$ 172,891
Liabilities		
Unearned premiums	$ -	$ 38,988
Unpaid claims	-	104,473
Liabilities of discontinued operations	$ -	$ 143,461

KINGSWAY FINANCIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

NOTE 7 SECURITIES:

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

				December 31, 2008
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Term deposits	$ 184,381	$ 3,610	$ 20	$ 187,971
Bonds:				
Canadian- Government	149,200	8,310	7	157,503
- Corporate	257,758	2,414	12,420	247,752
U.S. - Government	63,404	5,060	775	67,689
- Corporate	1,284,516	49,356	27,627	1,306,245
Other - Government	-	-	-	-
- Corporate	128,382	4,328	999	131,711
Sub-total	$ 2,067,641	$ 73,078	$ 41,848	$ 2,098,871
Common shares - Canadian	114,167	2,590	-	116,757
- U.S.	146,408	4,883	-	151,291
Preferred shares - Canadian	6,692	8	3,629	3,071
- U.S.	634	-	139	495
	$ 2,335,542	$ 80,559	$ 45,616	$ 2,370,485

				December 31, 2007
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Term deposits	$ 393,788	$ 836	$ 69	$ 394,555
Bonds:				
Canadian- Government	260,309	4,164	115	264,358
- Corporate	368,243	1,834	6,464	363,613
U.S. - Government	90,305	2,270	13	92,562
- Corporate	1,461,177	23,153	8,657	1,475,673
Other - Government	15,492	-	106	15,386
- Corporate	204,876	4,381	812	208,445
Sub-total	$ 2,794,190	$ 36,638	$ 16,236	$ 2,814,592
Common shares - Canadian	224,086	25,624	12,786	236,924

	- U.S.	194,545	16,045	12,847	197,743
Preferred shares	- Canadian	8,211	-	1,828	6,383
	- U.S.	780	-	57	723
		$ 3,221,812	$ 78,307	$ 43,754	$ 3,256,365

The following tables highlight the aggregate unrealized loss position, by security type, of holdings in an unrealized loss position as at December 31, 2008 and 2007. The tables segregate the holdings based on the period of time the securities have been continuously held in an unrealized loss position.

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KINGSWAY FINANCIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

				December 31,2008
	0-6 months	6-12 months	Over 12 months	Total
Preferred Shares				
Number of positions	-	1	6	7
Fair value	$ -	$ 101	$ 3,466	$ 3,567
Carrying value	-	104	7,231	7,335
Unrealized loss	-	(3)	(3,765)	(3,768)
Term Deposits and Bonds				
Number of positions	113	96	91	300
Fair value	$ 217,118	$ 184,996	$ 167,224	$ 569,338
Carrying value	225,893	202,586	182,707	611,186
Unrealized loss	(8,775)	(17,590)	(15,483)	(41,848)
Total				
Number of positions	113	97	97	307
Fair value	$ 217,118	$ 185,097	$ 170,690	$ 572,905
Carrying value	225,893	202,690	189,938	618,521
Unrealized loss	(8,775)	(17,593)	(19,248)	(45,616)

				December 31,2007
	0-6 months	6-12 months	Over 12 months	Total
Common and Preferred Shares				
Number of positions	154	32	7	193
Fair value	$ 176,701	$ 26,630	$ 1,662	$ 204,993
Carrying Value	196,584	33,725	2,202	232,511
Unrealized Loss	(19,883)	(7,095)	(540)	(27,518)
Term Deposits and Bonds				
Number of positions	127	84	166	377
Fair value	$ 297,337	$ 174,687	$ 543,268	$1,015,292
Carrying value	301,917	179,921	549,690	1,031,528
Unrealized loss	(4,580)	(5,234)	(6,422)	(16,236)
Total				
Number of positions	281	116	173	570
Fair value	$ 474,038	$ 201,317	$ 544,930	$1,220,285
Carrying value	498,501	213,646	551,892	1,264,039
Unrealized loss	(24,463)	(12,329)	(6,962)	(43,754)

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

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

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

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

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

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

The Company has elected to liquidate its entire common equity securities portfolio. As a result all common equity securities in an unrealized loss position as at December 31, 2008 are considered to be other than temporarily impaired.

As a result of the above analysis performed by management to determine declines in market value that are other than temporary, write-downs for other-than-temporary impairments were $134.3 million (2007 - $18.6 million) during the year. These impairment charges included $115.3 million (2007 - $18.6 million) from the write down of common stocks and $19.0 million (2007 - $nil) from the write-down of debt securities, including $13.7 million on bonds issued by Lehman Brothers, which declared bankruptcy.

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

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

	2008	2007	2006
Investment income:			
Interest on short-term investments	$ 11,433	$ 20,566	$ 15,941

Interest on bonds	108,366	106,997	89,698
Dividends	10,970	12,347	11,919
Premium finance	4,307	2,547	3,168
Other	2,255	1,828	2,256
Gross investment income	137,331	144,285	122,982
Investment expenses	7,029	8,146	7,622
Net investment income	$ 130,302	$ 136,139	$ 115,360

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

	2008	2007	2006
Fixed income	$ 6,269	$ (5,429)	$ (7,425)
Equities	(10,960)	70,848	40,196
Capital assets	-	5,400	-
Other than temporary impairment	(134,280)	(18,632)	(4,120)
Net realized gains and (losses)	$ (138,971)	$ 52,187	$ 28,651

NOTE 8 FINANCIAL INSTRUMENTS:

(a) Financial risk management objectives and policies:

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

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

Credit risk:

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

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

	2008		2007	
AAA/Aaa	$ 1,146,703	54.7%	$ 1,516,064	53.9%
AA/Aa2	341,280	16.3	661,891	23.5
A/A2	505,748	24.1	470,909	16.7
BBB/Baa2	65,255	3.1	96,076	3.4

BB/Ba2	5,122	0.2	8,081	0.3
B/B2	7,838	0.4	12,629	0.4
CCC/Caa or lower, or not rated	26,925	1.2	48,942	1.8
Total	$ 2,098,871	100.0%	$ 2,814,592	100.0%

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Market risk:

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

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

It is estimated that an immediate hypothetical 100 basis point increase in interest rates would decrease the market value of the fixed income securities by $69.9 million (2007 - $92.3 million), representing 3.3% (2007 - 3.3%) of the $2,098.9 million (2007 - $2,814.6 million) fair value fixed income securities portfolio.

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

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

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

Equity price risk:

The Company is exposed to changes in the value of equity securities as a result of market conditions. This is the risk of loss due to adverse movement in equity prices and comprises two key components i.e. general equity risk, which refers to fluctuations in value of the equity securities due to changes in general economic or stock market conditions and specific equity risk which refers to equity price volatility that is determined by entity specific characteristics.

Fluctuation in value of the equities affect the carrying value of these securities and the level and timing of recognition of gains and losses on securities held, causing changes in realized and unrealized gains and losses.

Equity price risk is mitigated through diversification. The equity portfolio is managed through the use of services of third party professional investment management firms and their performance is actively monitored by management and the Investment Committee of the Board of Directors.

As at December 31, 2008, management estimates that a 10% increase in equity prices, with all other variables held constant, would increase Other comprehensive income and Comprehensive income before tax by $27.2 million (2007-$44.2 million). A 10% decrease in equity prices would have the corresponding opposite effect on Other comprehensive income and Comprehensive income. Equities comprise 11.5% (2007- 13.6%) of the Company's investment portfolio as at December 31, 2008.

The Company has elected to significantly reduce this equity risk by liquidating the entire common equity portfolio.

Foreign currency risk:
The Company is exposed to foreign currency risk with respect to securities, receivables and policies denominated in foreign currencies. This is the risk of loss due to adverse movement of currency exchange rates. The Company has a smaller exposure to changes in the U.S. to Canadian dollar foreign currency exchange rate. It does not hedge any foreign currency exposure that may exist in the securities portfolio. Its U.S. operations generally hold their investments in U.S. dollar denominated securities, and the Canadian operations in Canadian dollar denominated securities. The Company has a cash flow hedge in place to lock in U.S. dollar cash flow requirements on interest and principal payments of a Canadian dollar debt obligation. Refer to Note 10 for further details.

Liquidity and cash flow risk:

Liquidity risk is the risk of having insufficient cash resources to meet current financial obligations without raising funds at unfavorable rates or selling assets on a forced basis. Liquidity risk arises from general business activities and in the course of managing the assets and liabilities. There is the risk of loss to the extent that that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows. Cash flow risk arises from risk that future inflation of policyholder cash flow exceeds returns on long-dated investment securities. The purpose of liquidity and cash flow management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. The liquidity and cash flow requirements of the Company's business have been met primarily by funds generated from operations, asset maturities and income and other returns received on securities. Cash provided from these sources is used primarily for claims and claim adjustment expense payments and operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements. To meet these cash requirements, the Company has policies to limit and monitor its exposure to individual issuers or related groups and to ensure that assets and liabilities are broadly matched in terms of their duration and currency. The Company believes that it has the flexibility to obtain, from internal sources, the funds needed to fulfill the cash requirements during the current financial year and also to satisfy regulatory capital requirements. For Lincoln General Insurance Company ("Lincoln"), a comprehensive run-off plan is being prepared for submission to the Pennsylvania Insurance Department with an objective to demonstrate that no additional funding will be required from the Company, absent any unexpected adverse developments. This comprehensive plan is subject to approval by the Pennsylvania Insurance Department. Achievement of the comprehensive plan depends on future events and circumstances, the outcome of which cannot be assured. Refer to Note 9 for further details.

As a holding company, Kingsway derives cash from its subsidiaries generally in the form of dividends and management fees to meet its obligations, which primarily consist of dividend and interest payments. The Company's insurance subsidiaries fund their obligations primarily through the premium and investment income and maturities in the securities portfolio. The operating insurance subsidiaries require regulatory approval for the return of capital and, in certain circumstances, prior to the payment of dividends. In the event that dividends and management fees available to the holding company were inadequate to services its obligations, the Company would need to raise capital, sell assets or restructure its debt obligations. The Company's dividend payments are reviewed and determined quarterly by the Company's Board of Directors. Kingsway holds $293.7 million in cash and high grade short-term assets, representing approximately 12% of invested assets. The majority of the other fixed income securities are also liquid.

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The following table summarizes carrying amounts of financial instruments by contractual maturity or expected cash flow dates (the actual repricing dates may differ from contractual maturity because certain securities and debentures have the right to call or prepay obligations with or without call or prepayment penalties):

As at December 31

	One year or less	One to five years	Five to ten years	More than ten years	No specific date	Total
Assets:						
Cash and cash equivalents	$ 105,656	$ -	$ -	$ -	$ -	$ 105,656
Securities	405,619	986,244	524,479	182,529	271,614	2,370,485
Accrued investment income	24,554	-	-	-	-	24,554
Finance premiums	61,616	-	-	-	-	61,616
Accounts receivable and other assets	276,450	-	-	-	-	276,450
Due from reinsurers and other insurers	63,195	95,990	16,533	2,227	-	177,945
Total:	937,090	1,082,234	541,012	184,756	271,614	3,016,706
Liabilities:						
Loans payable	-	-	66,222	-	-	66,222
Accounts payable and accrued liabilities	135,565	-	-	-	-	135,565
Unpaid claims	667,307	1,013,611	174,579	23,519	-	1,879,016
Senior unsecured debentures	-	81,137	104,066	-		185,203
Subordinated indebtedness	-	-	-	87,383	-	87,383
Total:	802,872	1,094,748	344,867	110,902	-	2,353,389

The coupon rates for the fixed term securities range from 2.4% to 15.0% at December 31, 2008 (2.5% to 12.0% at December 31, 2007). The average effective yield (using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts) is 4.6% (2007 - 4.7%).

(b) Fair value:

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

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

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

Refer to Note 7 with respect to fair value disclosure on securities.

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of quoted market prices (Level 1), internal models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of securities as at December 31, 2008 was as follows:

As at December 31, 2008		
Description	Available for sale securities	
	Equity	Fixed income
Fair value	$ 271,614	$ 2,098,871
Based on:		
Quoted market prices	100.0%	-
Valuation techniques-Significant market observable Inputs	-	100.0%
Valuation techniques- Significant unobservable market inputs	-	-

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

As at December 31	Total Fair Value*	Total Carrying Value	2008 Favourable/ (Unfavourable)
Loans payable	$ 43,094	$ 66,222	$ 23,128
Senior unsecured debentures	128,497	185,203	56,706
Subordinated indebtedness	17,712	87,383	69,671
	Total Fair Value*	Total Carrying Value	2007 Favourable/ (Unfavourable)
Loans payable	$ 54,493	$ 66,222	$ 11,729
Senior unsecured debentures	221,517	220,080	(1,437)
Subordinated indebtedness	90,500	87,354	(3,146)

* The fair value is based on market observable inputs.

The carrying value of unpaid claims does not take into consideration the time value of money or make an explicit provision for adverse deviation. In order to estimate the fair value of the unpaid claims, the Company uses an actuarial approach recognizing the time value of money which incorporates assumptions concerning projected cash flows and appropriate provisions for adverse deviation. As at December 31, 2008, the estimated fair value of unpaid claims was $2,023.9 million ($1,889.7 million net of reinsurers' share of unpaid claims). The estimated fair value is approximately $145 million above the undiscounted carrying value as a result of the inclusion of a provision for adverse development totaling $191.1 million in addition to the present value of unpaid claims. There is no active market for policy liabilities; hence market value is not available.

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

NOTE 9 CAPITAL MANAGEMENT:

Objectives, policies and procedures:

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

There were no significant changes made in the objectives, policies and procedures during the year.

Regulatory capital requirements and ratios:

As at December 31, 2008 the Company was adequately capitalized to support the premium volume of the insurance subsidiaries. Canadian property and casualty insurance companies are regulated by the Office of the Superintendent of Financial Institutions (OSFI) and the Financial Services Commission of Ontario (FSCO) and are required to maintain a level of capital sufficient to achieve a target of 150% of a minimum capital test (MCT) ratio. As at December 31, 2008 the MCT's of the Canadian subsidiaries are above the 150% MCT level, with MCT ratios ranging between 186% and 190% (2007- 240% and 266%) and aggregate capital of approximately $30.1 million (2007-$109.1 million) in excess of the 150% level.

In the United States, a risk based capital (RBC) formula is used by the National Association of Insurance Commissioners (NAIC), which has been generally adopted in all states, as a benchmark to measure capital levels in property and casualty insurance companies. The NAIC requires that capital and surplus not fall below 200% of the authorized control level as determined by this model. As at December 31, 2008, all the U.S. subsidiaries, with the exception of Lincoln, are above the required RBC levels, with RBC ratios ranging between 211% and 34,129% (2007-156% and 1,413%) and aggregate capital of approximately $96.2 million (2007-$91.5 million) in excess of the 200% level. As at December 31, 2008 Lincoln's RBC was 117% (2007- 153%) which is at the regulatory action level. Based on the current RBC level, an additional $56.1 million would be required to increase the RBC level above 200%. As a result of its current RBC level, the Pennsylvania Insurance Department is required to conduct an examination and issue an order outlining corrective action to be taken. Further, under Pennsylvania law, Lincoln may be deemed to be operating in a financially hazardous condition based on its financial statements at December 31, 2008. As a result, the Pennsylvania Insurance Department has the power to take a variety of regulatory actions, including but not limited to department supervision, and the seeking of a court order of rehabilitation or liquidation if it determines that Lincoln's condition is such that the further transaction of business would be hazardous, financially, to its policyholders, creditors or the public.

As part of a plan developed by management, Lincoln has initiated running off its book of business and, accordingly, management has ceased writing new or renewal business and has initiated mid-term cancellations in certain lines of business. As at December 31, 2008, Lincoln had statutory admitted assets of $386.7 million, liabilities of $307.5 million and statutory surplus of $79.2 million. On March 11, 2009, Lincoln entered into a letter agreement with the Pennsylvania Insurance Department that provides for increased supervisory oversight by the Department including but not limited to increased reporting and department approval of non-routine matters including transfers or pledges of assets, extension of loans, incurring of debt, increases in salaries, payments of bonuses to officers and directors, and consummation of material transactions.

Lincoln has commenced preparation of a comprehensive plan which it intends to file with the Pennsylvania Insurance Department in April 2009. It is intended to outline Lincoln's future plans, including the current and projected RBC level and is subject to approval by the Pennsylvania Insurance Department. Achievement of the comprehensive plan depends on future events and circumstances, the outcome of which cannot be assured.

The reinsurance subsidiaries, which are domiciled in Barbados and Bermuda, are required by the regulator in the jurisdictions in which they operate to maintain minimum capital levels. As at December 31, 2008 the capital maintained by Kingsway Reinsurance Corporation was approximately $77.9 million (2007 - $298.7 million) in excess of the regulatory requirements in Barbados and the capital maintained by Kingsway Reinsurance (Bermuda) Limited was approximately $15.4 million (2007 - $80.9 million) in excess of regulatory requirements.

NOTE 10 HEDGES:

On July 10, 2007, a general partnership of the Company (Kingsway 2007 General Partnership) issued a five year C$100 million debt obligation due on July 11, 2012 with fixed semi-annual C$3 million interest payments. Kingsway 2007 General Partnership's risk management objective is to lock in the cash flow requirements on this debt obligation in U.S. dollar terms which is the currency in which its cash inflows are received, thus mitigating exposure to variability in expected future cash flows. In order to meet this objective, Kingsway 2007 General Partnership has entered into a cross-currency swap with Bank of Nova Scotia to swap U.S. dollar cash flows into Canadian dollar cash flows providing the Company with the required Canadian dollar funds each semi-annual period and upon maturity to settle the senior debenture offering interest payments.

The swap transaction has been designated as a cash flow hedge. Any changes in the fair value of the hedging instruments are recorded in other comprehensive income until the hedged item affects the Consolidated Statement of Income. Hedge ineffectiveness is measured and recorded in the current period in the Consolidated Statement of Income. The Company has recorded a $0.1 million loss during the year due to the ineffective portion of the designated hedge. As at December 31, 2008, the time length of the cash flow hedge outstanding was less than four years. When the hedge is discontinued, any cumulative adjustment to either the hedged item or other comprehensive income will be recognized in income over the remaining term of the original hedge, or when the hedged item is de-recognized. The swap agreement has an annual early termination date that can be exercised by either party. The cost to the Company to settle the swap as at December 31, 2008 was $14,500,000.

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NOTE 11 CAPITAL ASSETS:

	Cost	Accumulated Amortization	2008 Carrying Value
Land	$ 9,916	$ -	$ 9,916
Buildings	77,916	8,884	69,032
Leasehold improvements	13,850	4,633	9,217
Furniture and equipment	12,129	7,626	4,503
Computers and software	49,244	28,810	20,434
Automobiles	1,210	937	273
Total	$ 164,265	$ 50,890	$ 113,375

	Cost	Accumulated Amortization	2007 Carrying Value
Land	$ 11,462	$ -	$ 11,462
Buildings	89,687	7,304	82,383
Leasehold improvements	13,077	3,694	9,383
Furniture and equipment	14,941	7,605	7,336
Computers and software	45,595	23,308	22,287
Automobiles	2,069	1,489	580
Total	$ 176,831	$ 43,400	$ 133,431

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NOTE 12 SHARE CAPITAL:

Authorized:
Unlimited number of common shares
Share transactions consist of the following:

	Shares Issued	Stock Options	Weighted-Average Exercise Price*	Amount
Balance as at December 31, 2005	56,480,453	1,967,515	$ 15.66	$ 331,470
Stock options:				
Granted in year		611,350	24.55	
Exercised in year	209,072	(209,072)	14.12	2,604
Forfeited in year		(24,917)	19.50	
Stock-based compensation expense				400
Normal course issuer bid Note 12(e)	(805,000)	-	-	(6,001)
Balance as at December 31, 2006	55,884,525	2,344,876	$ 18.07	$ 328,473
Stock options:				
Granted in year		571,000	23.00	
Granted in year		25,000	12.08	
Exercised in year	76,303	(76,303)	12.98	880
Forfeited in year		(91,750)	22.30	
Stock-based compensation expense				202
Normal course issuer bid Note 12(f)	(445,100)			(3,404)
Balance as at December 31, 2007	55,515,728	2,772,823	$ 19.03	$ 326,151
Stock options:				
Granted in year		652,350	13.47	
Granted in year		12,000	9.84	
Granted in year		3,000	9.60	
Exercised in year	21,000	(21,000)	4.30	89
Forfeited in year		(92,334)	19.74	
Normal course issuer bid Note 12(g)	(468,200)			(3,896)
Balance as at December 31, 2008	55,068,528	3,326,839	$ 17.97	$ 322,344

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

(a) During the year ended December 31, 2008, options to acquire 21,000 shares (2007 - 76,303; 2006 - 209,072 shares) were exercised at C$4.30 per share (2007 - C$4.30 to C$19.70 per share; 2006 - C$4.30 to C$19.70 per share).

(b) The weighted average number of shares outstanding for the years ended December 31, 2008, 2007 and 2006 were 55,196,596, 56,656,913 and 56,233,964, respectively. On a diluted basis, the weighted average number of shares outstanding for the years ended December 31, 2008, 2007 and 2006 were 55,250,693, 55,944,060 and 56,868,785, respectively.

(c)

During 2008, the Company declared dividends payable in Canadian dollars of C$0.075 per share payable for each quarter. Total dividends declared in 2008 were C$0.30 per common share. Dividends paid to common shareholders during 2008 were C$16,548,983 and C$16,685,633 in 2007.

(d) Options exercised during the year resulted in an increase in share capital from contributed surplus of $89,000 for the year ended December 31, 2008 and $202,000 for the year ended December 31, 2007.

(e) On November 9, 2006, the Company obtained approval from the Toronto Stock Exchange to make a normal course issuer bid for its common shares. For the twelve month period ending November 8, 2007 the Company could repurchase up to 2,800,000 of its common shares in total representing approximately 5% of the then outstanding common shares. For the period of November 9, 2006 to December 31, 2006, the Company had repurchased 242,200 of its common shares at an average price of $21.16. For the year ended December 31, 2006 the Company had repurchased a total of 805,000 of its common shares at an average price of $20.11. All of the repurchased common shares were cancelled.

(f) On November 9, 2007, the Company obtained approval from the Toronto Stock Exchange to make a normal course issuer bid for its common shares. For the twelve month period commencing November 13, 2007 and ending November 12, 2008, the Company could repurchase up to 2,780,000 of its common shares representing less than 5% of the then outstanding shares. For the period of November 13, 2007 to December 31, 2007, the Company had repurchased 123,700 of its common shares at an average price of $16.68. For the year ended, December 31, 2007 the Company had repurchased a total of 445,100 of its common shares at an average price of $18.20. All of the repurchased common shares were cancelled.

(g) On November 28, 2008, the Company obtained approval from the Toronto Stock Exchange to make a normal course issuer bid for its common shares. For the twelve month period commencing December 2, 2008 and ending December 1, 2009, the Company may repurchase up to 2,753,426 of its common shares representing approximately 5% of the then outstanding shares. For the period of December 2, 2008 to December 31, 2008, the Company did not repurchase any common shares. For the year ended, December 31, 2008 the Company had repurchased a total of 468,200 of its common shares at an average price of $11.02. All of the repurchased common shares were cancelled.

NOTE 13 STOCK-BASED COMPENSATION:

(a) The Company has established a stock option incentive plan for directors, officers and key employees of the Company and its subsidiaries. At December 31, 2008, the maximum number of common shares that may be issued under the plan is 4,800,000 (2007 - 4,800,000) common shares. The maximum number of common shares available for issuance to any one person under the stock option plan is 5% of the common shares outstanding at the time of the grant. Additional stock compensation relating to EIC 162 for eligible employees for fiscal years 2008 and 2007 was $32,000 and $145,000 respectively.

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

The intrinsic value of a stock option grant is the difference between the current market price for the Company's common shares and the exercise price of the option. The aggregate intrinsic values for the stock options outstanding at December 31, 2008, 2007 and 2006 were nil, nil and C$14.6 million, respectively. The aggregate intrinsic values for stock options exercisable at December 31, 2008, 2007 and 2006 were nil, nil and C$11.9 million, respectively.

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The following tables summarize information about stock options outstanding as at December 31, 2008, December 31, 2007 and December 31, 2006:

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

December 31, 2008

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$	9.60	02-Sep-08	02-Sep-13	4.7	3,000	-
C$	9.84	12-May-08	12-May-13	4.4	12,000	-
C$	13.47	15-Feb-08	15-Feb-13	4.1	639,850	-
C$	12.08	31-Dec-07	31-Dec-10	2.0	25,000	25,000
C$	23.00	12-Feb-07	12-Feb-12	3.1	535,250	245,083
C$	24.55	13-Feb-06	13-Feb-11	2.1	540,100	393,400
C$	19.70	14-Feb-05	14-Feb-10	1.1	455,867	455,867
C$	15.19	12-Feb-04	12-Feb-09	0.1	333,735	333,735
C$	13.53	10-Feb-03	10-Feb-13	4.1	315,334	315,334
C$	19.66	21-Feb-02	21-Feb-12	3.1	287,000	287,000
C$	7.80	22-Feb-01	22-Feb-11	2.2	122,002	122,002
C$	4.30	24-Feb-00	14-Feb-10	1.2	57,701	57,701
	Total			2.6	3,326,839	2,235,122

December 31, 2007

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$	12.08	31-Dec-07	31-Dec-10	3.0	25,000	25,000
C$	23.00	12-Feb-07	12-Feb-12	4.1	552,750	-
C$	24.55	13-Feb-06	13-Feb-11	3.1	558,600	186,200
C$	19.70	14-Feb-05	14-Feb-10	2.1	478,700	316,033
C$	15.19	12-Feb-04	12-Feb-09	1.1	342,736	342,736
C$	13.53	10-Feb-03	10-Feb-13	5.1	319,334	319,334
C$	19.66	21-Feb-02	21-Feb-12	4.2	295,000	295,000
C$	7.80	22-Feb-01	22-Feb-11	3.2	122,002	122,002
C$	4.30	24-Feb-00	14-Feb-10	2.2	78,701	78,701
	Total			3.2	2,772,823	1,685,006

December 31, 2006

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$	24.55	13-Feb-06	13-Feb-11	4.1	603,850	-
C$	19.70	14-Feb-05	14-Feb-10	3.1	512,951	162,784

C$	15.19	12-Feb-04	12-Feb-09	2.1	365,737	224,237
C$	13.53	10-Feb-03	10-Feb-13	6.1	329,335	329,335
C$	19.66	21-Feb-02	21-Feb-12	5.2	306,000	306,000
C$	7.80	22-Feb-01	22-Feb-11	4.2	127,002	127,002
C$	4.30	24-Feb-00	14-Feb-10	3.2	100,001	100,001
	Total			4.0	2,344,876	1,249,359

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At December 31, 2008, 2007 and 2006 the number of options exercisable were 2,235,122, 1,685,006 and 1,249,359, respectively, with weighted average prices of C$18.23, C$16.45 and C$14.81, respectively.

The Company determines the fair values of options granted using the Black-Scholes option pricing model. Per share fair value of options granted in February 2008 was C$2.88, May 2008 was C$2.43 and September 2008 was C$2.45. Fair value of options granted in February 2007 was C$5.34 and in December 2007 was C$2.38. Fair value of options granted in 2006 was C$6.88.

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

	2008	2007	2006
Stock option expense included in employee compensation expense	$ 2,172	$ 2,468	$ 2,515
Net income (loss), as reported	$(405,865)	$ (18,526)	$ 123,309
Additional expense that would have been recorded if all outstanding stock options granted before January 1, 2003 had been expensed	-	-	68
Pro forma net income (loss)	$(405,865)	$ (18,526)	$ 123,309
Basic earnings (loss) per share			
As reported	$ (7.35)	$ (0.33)	$ 2.19
Pro forma	(7.35)	(0.33)	2.19
Diluted earnings (loss) per share			
As reported	$ (7.35)	$ (0.33)	$ 2.17
Pro forma	(7.35)	(0.33)	2.17

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

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

	Sep 2008	May 2008	Feb 2008	Dec 2007	Feb 2007	2006
Risk-free interest rate	2.91%	3.03%	3.22%	3.82%	4.11%	4.02%
Dividend yield	3.1%	3.1%	2.2%	2.5%	1.3%	1.02%
Volatility of the expected market price of the Company's common shares	37.6%	35.8%	27.8%	28.8%	25.2%	31.4%
Expected option life (in years)	4.0	4.0	4.0	3.0	4.0	3.5

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

(b) The Company has an employee share purchase plan where qualifying employees can choose each year to have up to 5% of their annual base earnings withheld to purchase the Company’s common shares. The Company matches one half of the employee contribution amount, and its contributions vest immediately. All contributions are used by the plan administrator to purchase common shares in the open market. The Company’s contribution is expensed as paid and for the years ended December 31, 2008, 2007 and 2006 totaled $840,000, $885,000 and $727,000, respectively.

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(c) Effective May 2008, the Company has a deferred share unit ("DSU") program that allows the Board of Directors to elect to receive director fees in the form of deferred share units rather than cash.

DSUs elected by or awarded to a director are credited to an account maintained for each director by the Company. The number of DSUs to be credited is determined by dividing the amount of the director's remuneration to be deferred into DSUs on that date by the fair market value per share on that date.

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

The table below shows the deferred share units elected and the director's remuneration deferred into DSUs during the year:

Deferred share units		2008
	Units	Amount
Balance, beginning of year	-	$ -
Units awarded during the year	32,327	265
Units redeemed for cash payment	-	-
Balance, end of year	32,327	265

NOTE 14 PENSION BENEFITS:

The Company maintains separate defined contribution pension plans in Canada and in the U.S. for all of its qualified employees including the employees of all subsidiaries. In Canada, qualifying employees can choose each year to have up to 5% of their annual base earnings subject to the maximum Registered Retirement Savings Plan ("RRSP") deduction limit, withheld to contribute to the applicable plan. The RRSP deduction limit is the lesser of 18% of earned income for the preceding year or C$20,000, C$19,000 and C$18,000 for 2008, 2007 and 2006 respectively. The Company matches one half of the employee contribution amount, and its contributions vest immediately. In the U.S., qualifying employees can choose to voluntarily contribute up to 60% of their annual earnings subject to an overall limitation of $15,500 in 2008, $15,500 in 2007 and $15,000 in 2006. The Company matches 50% of the employee contribution amount each payroll period up to 5%.

The contributions for the U.S. plan vest based on years of service with 100% vesting after five years of service. The Company's contribution is expensed as paid and for the years ended December 31, 2008, 2007 and 2006 totaled $1,643,000, $1,389,000, and $1,581,000, respectively. All Company obligations to the plans were fully funded as of December 31, 2008.

Prior to December 31, 1997, substantially all salaried employees of the Company's subsidiary American Country were covered by a defined benefit pension plan sponsored by American Country. Effective December 31, 1997, upon resolution of its Board of Directors, the plan was frozen. The reported pension expense for American Country was $53,000, $25,000 and $104,000 in 2008, 2007, and 2006 respectively.

NOTE 15 UNDERWRITING POLICY AND REINSURANCE CEDED:

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

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

Underwriting risk:

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

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

Pricing risk:

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

Reinsurance risk:

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

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

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Years ended December 31

		2008		2007		2006
Property claims						
- Canadian operations	C$	1,000	C$	1,000	C$	1,000
- U.S. operations	$	500	$	500	$	500
Casualty claims						
- Canadian operations	C$	2,500	C$	2,500	C$	2,500
- U.S. operations	$	1,000	$	1,000	$	1,000

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

Years ended December 31

		2008		2007		2006
Canada						
- Retained loss	C$	5,000	C$	5,000	C$	5,000
- Maximum coverage	C$	120,000	C$	120,000	C$	145,000
United States						
- Retained loss	$	2,000	$	5,000	$	5,000
- Maximum coverage	$	38,000	$	35,000	$	20,000

On October 31, 2005, the Company acquired Zephyr Insurance Inc. ("Zephyr") in Hawaii. Zephyr is protected by a separate catastrophe reinsurance program under a 95% quota-share treaty and excess of loss treaty. Under this program Zephyr retains up to $7,500,000 in net losses subject to a maximum cover of $1,200,000,000.

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

		2008		2007		2006
Net premiums earned	$	133,366	$	139,188	$	127,274
Claims incurred		51,984		31,007		39,256
Commissions and premium taxes		30,649		29,554		29,018

The amounts of assumed premiums written were $96,455,000, $80,225,000 and $86,211,000 for the years ended December 31, 2008, 2007 and 2006, respectively. The amounts of assumed premiums earned were $89,686,000, $84,221,000 and $93,091,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

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NOTE 16 INCOME TAXES:

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

	2008	2007	2006
Provision for taxes at Canadian statutory marginal income tax rate	$(119,219)	$ (12,629)	$ 46,204
Valuation allowance	159,850	20,202	-
Non-taxable investment income	(1,075)	(742)	(372)
Foreign operations subject to different tax rates	14,865	(16,860)	(33,892)
Change in tax rates and other	18,953	5,879	3,037
Provision for income taxes for continuing operations	$ 73,374	$ (4,150)	$ 14,977

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

	2008	2007
Future income tax assets:		
Losses carried forward	$ 142,566	$ 105,222
Unpaid claims and unearned premiums	30,117	30,123
Securities	18,030	2,032
Share issue expenses	-	158
Profit commission accruals	8,914	2,131
Other	14,265	9,432
Valuation allowance	(180,550)	(20,700)
Future income tax assets	33,342	128,398
Future income tax liabilities:		
Deferred policy acquisition costs	(5,716)	(5,104)
Securities	(1,095)	(3,958)
Guaranteed payments	(1,240)	(4,931)
Other	-	(339)
Future income tax liabilities	(8,051)	(14,332)
Net future income tax assets	$ 25,291	$ 114,066

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

	Year of net operating loss	Expiration date	Net operating loss
U.S. operations:	1995	2010	$ 546
	1997	2012	1,284
	2000	2020	507
	2001	2021	14,936
	2002	2022	4,367
	2003	2023	213
	2004	2024	195

2005	2025	282
2006	2026	75,729
2007	2027	184,529
2008	2028	136,724

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(d) The Company established valuation allowances of $180,550,000 and $20,700,000 for its gross future tax assets at December 31, 2008 and 2007, respectively. Based on the Company's expectations of taxable income, its ability to change its investment strategy, as well as reversing gross future tax liabilities, management believes it is more likely than not that the Company will fully realize the gross future tax assets (Canadian operations - $18,332,000, U.S. operations - $6,959,000), with the exception of the aforementioned valuation allowance. The Company has, therefore established the valuation allowance at December 31, 2008 as a result of the potential inability to utilize a portion of its net operating losses in the U.S. that do not expire for up to 20 years. The uncertainty over the Company's ability to utilize a portion of these losses over the short term has led to the Company recording valuation allowances.

NOTE 17 UNPAID CLAIMS:

(a) Nature of unpaid claims:

The establishment of the estimated provision for unpaid claims is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors include the Company's experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims, product mix or concentration, claims severity and claim frequency patterns.

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

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

(b) Provision for unpaid claims:

The Company's annual evaluation of the adequacy of unpaid claims includes a re-estimation of the liability for unpaid claims relating to each preceding financial year compared to the liability that was originally established. The results of this comparison and the changes in the provision for unpaid claims, net of amounts recoverable from reinsurers, for the years ended December 31, 2008, 2007 and 2006 were as follows:

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	2008	2007	2006
Unpaid claims - beginning of year - net	$ 2,089,411	$1,762,932	$1,662,551
Net unpaid claims of subsidiaries acquired (disposed)	(151,060)	65,332	-
Provision for claims occurring:			
In the current year	1,114,759	1,256,767	1,170,484
In prior years	160,780	180,395	64,329
Claims paid during the year relating to:			
The current year	(434,594)	(520,557)	(409,236)
The prior years	(855,559)	(801,887)	(745,286)
Currency translation adjustment	(172,119)	146,429	20,090
Unpaid claims - end of year - net	1,751,618	2,089,411	1,762,932
Reinsurers' and other insurers' share of unpaid claims	127,398	177,671	176,431
Unpaid claims - end of year	$ 1,879,016	$2,267,082	$1,939,363

The results for the years ended December 31, 2008, 2007 and 2006 were adversely affected by the evaluation of unpaid claims related to prior years. In 2006, 2007 and 2008 unfavourable development on unpaid claims came primarily from long-haul trucking claims in the U.S. and from allocated loss adjustment expenses on contractor property claims in the U.S.

Canadian Operations

The Canadian operations reported unfavourable reserve development of $14.1 million in the 2008 compared to favourable reserve development of $32.0 million in 2007. Non-standard automobile contributed $1.3 million of unfavourable development in 2008 compared to favourable reserve development of $14.3 million and $5.4 million in 2007 and 2006, respectively. Ontario non-standard automobile business contributed $4.2 million of the unfavourable development in 2008 and Alberta contributed $3.0 million of favourable reserve development compared to $10.1 million and $3.3 million of unfavourable development in 2007, respectively. Ontario motorcycle contributed $10.6 million of unfavourable reserve development in 2008 compared to $0.7 million in 2007. The most recent accident years, primarily 2007, contributed to the majority of the unfavourable reserve development in Ontario automobile due to the escalation in claims costs.

U.S. Operations

The U.S. operations reported unfavourable reserve development of $146.7 million in 2008 compared to $212.4 million in 2007. The Company previously outsourced the claims settlement and case reserving process for the U.S. program business. Over the last few years a concerted effort has been made to bring most of these arrangements in-house and the Company has significantly increased the internal resources as part of this focused initiative. As part of these initiatives a comprehensive review of all claim reserves previously handled by third parties has been completed over the period. This review process identified several areas where based on the current information available the previous claims reserves were inadequate resulting in unfavourable development of the prior years' claims reserves. Trucking business contributed $102.3 million of the prior years' claims development in 2008, compared to $149.7 million in 2007 and $59.4 million in 2006. Property and liability business contributed $51.6 million of the prior years' claims development in 2008, compared to $58.3 million in 2007 and $13.5 million in 2006. Allocated loss adjustment expenses on contractors' claims in the property and liability segment contributed $70.3 million in prior years' claims development in 2008 and $53.6 million in 2007 which was offset by favourable development on other property business.

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(c) Ranges of unpaid claims:

The Company's policy is, to the extent that management's estimates of gross reserve levels at our individual insurance subsidiaries are less than the actuarial central estimate recommended by their independent appointed actuary, those gross reserve levels will be increased to levels that are no less than the actuarial central estimates recommended by the independent appointed actuary. The ranges of provision for gross unpaid claims for our U.S. and Canadian operations estimated by our independent actuary and the actual carried provision for unpaid claims were as follows:

As of December 31, 2008	Low	High	Actuarial Central Estimate	Carried
U.S. Operations	$ 1,145,608	$ 1,329,774	$ 1,237,011	$ 1,246,138
Canadian Operations	572,488	700,071	632,835	632,878
Total	$ 1,718,096	$ 2,029,845	$ 1,869,846	$ 1,879,016

As of December 31, 2007	Low	High	Actuarial Central Estimate	Carried
U.S. Operations	$ 1,201,228	$ 1,490,712	$ 1,332,360	$ 1,342,990
Canadian Operations	813,030	1,039,611	921,607	924,092
Total	$ 2,014,258	$ 2,530,323	$ 2,253,967	$ 2,267,082

NOTE 18 ACQUISITIONS:

(a) Robert Plan Corporation:

In 2006, the Company entered into an agreement with The Robert Plan Corporation (RPC) whereby the Company acquired the renewal rights of RPC's assigned risk business. As part of these arrangements, RPC has been given the authority to market the assigned risk programs on behalf of the Company and the Company has assumed certain operating functions related to this business. The Company recognized an intangible asset of $20,600,000 relating to this acquisition and amortization of $1,030,000 was recorded in 2006 and $2,060,000 in 2007. In January 2007, the Company acquired additional renewal rights from RPC and recognized an additional $14,444,213 for the intangible asset; related amortization of $1,444,421 was recorded in 2007. Total amortization in 2008 relating to the above intangibles was $3,504,000. The Company determined that the intangible assets have a definite life and will amortize it to income on a straight line basis over their defined useful life of 10 years.

(b) Mendota:

On April 1, 2007, the Company acquired 100% of the issued and outstanding shares of Mendota Insurance Company ("Mendota") in a cash transaction for a total purchase price of approximately $51,100,000. The earnings of Mendota have been included in the consolidated statement of operations since that date. Mendota's primary business is non-standard automobile insurance. This transaction included Mendota's wholly-owned subsidiaries, Mendakota Insurance Company and Mendota Insurance Agency, Inc.

The Company recognized initial goodwill of $970,000 and intangible assets of $10,669,000 in 2007 related to this acquisition. During 2008 the final goodwill balance was determined to be $1,182,000. Of the total acquired intangible assets, $7,803,000 was assigned to insurance licenses, with an indefinite life and is not subject to amortization. The remaining intangible assets of $2,866,000, of which $1,101,000 was assigned to computer software, will be amortized on a straight line basis over its defined useful life of 5 years and $1,765,000 assigned to agent relationships will also be amortized over a 5 year term but based on a pattern in which the economic benefits of the asset are expected to be consumed.

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The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition of Mendota.

	April 1, 2007
Cash	$ 30,526
Investments	87,628
Accounts receivable	34,755
Other tangible assets	10,033
Other assets	
Intangible asset - state insurance licenses	7,803
Intangible asset - agent relationships	1,765
Intangible asset - technology based	1,101
Goodwill	1,182
Total Assets	174,793
Insurance liabilities	120,770
Accounts payable	1,311
Other liabilities	1,600
Total liabilities	123,681
Purchase price	$ 51,112

NOTE 19 SEGMENTED INFORMATION:

The Company provides property and casualty insurance and other insurance related services in three reportable segments: Canada, the United States and corporate and other insurance related services. The Company's Canadian and United States segments include transactions with the Company's reinsurance subsidiaries. At the present time, other insurance related services are not significant. Results for the Company's operating segments are based on the Company's internal financial reporting systems and are consistent with those followed in the preparation of the consolidated financial statements. Segment information for the year 2008, 2007 and 2006 excludes discontinued operations.

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

	Canada	United States	Corporate and other	Total
Gross premiums written	$ 449,069	$1,054,122	$ -	$1,503,191
Net premiums earned	419,640	1,064,623	-	1,484,263
Investment income (loss)	47,788	82,027	487	130,302
Net realized gains (losses)	(106,372)	(74,010)	41,411	(138,971)
Interest expense	-	31,095	3,927	35,022
Amortization of capital assets	1,982	7,420	4,297	13,699
Amortization of intangible assets and goodwill impairment	-	67,076	687	67,763
Income tax expense (recovery)	(28,470)	98,884	2,960	73,374
Income (loss) from continuing operations	(79,758)	(398,064)	48,570	(429,252)

Capital assets	$ 47,823	$ 61,071	$ 4,481	$ 113,375
Goodwill and intangible assets	5,996	39,781	-	45,777
Total assets	1,082,936	2,215,929	44,576	3,343,441

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

	Canada	United States	Corporate and other	Total
Gross premiums written	$ 456,021	$1,392,697	$ -	$1,848,718
Net premiums earned	411,525	1,302,481	-	1,714,006
Investment income (loss)	53,289	84,230	(1,380)	136,139
Net realized gains (losses)	26,182	26,014	(9)	52,187
Interest expense	-	30,262	8,605	38,867
Amortization of capital assets	1,913	5,598	4,586	12,097
Amortization of intangible assets and goodwill impairment	-	4,007	-	4,007
Income tax expense (recovery)	18,125	(36,443)	14,168	(4,150)
Income (loss) from continuing operations	78,600	(86,889)	(22,524)	(30,813)
Capital assets	$ 62,098	$ 62,184	$ 9,149	$ 133,431
Goodwill and intangible assets	9,272	107,502	-	116,774
Total assets	1,775,063	2,840,912	41,430	4,657,405

The segmented information for December 31, 2006 is summarized as follows:

	Canada	United States	Corporate and other	Total
Gross premiums written	$ 439,034	$1,341,984	$ -	$1,781,018
Net premiums earned	397,941	1,204,053	-	1,601,994
Investment income (loss)	47,515	68,448	(603)	115,360
Net realized gains	15,908	12,743	-	28,651
Interest expense	-	23,086	7,161	30,247
Amortization of capital assets	1,160	3,332	1,625	6,117
Amortization of intangible assets and goodwill impairment	-	1,030	-	1,030
Income tax expense (recovery)	21,027	(15,410)	9,360	14,977
Income (loss) from continuing operations	58,657	62,721	(8,438)	112,940
Capital assets	$ 49,055	$ 55,915	$ 3,179	$ 108,149
Goodwill and intangible assets	7,887	82,963	-	90,850
Total assets	1,508,561	2,507,123	32,654	4,048,338

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

	2008	2007	2006
Business Line			
Personal Lines:			
Non-standard Auto	43%	33%	28%
Standard Auto	1%	0%	0%
Motorcycle	5%	4%	4%
Property (including Liability)	7%	6%	6%
Other Specialty Lines	2%	2%	1%
Total Personal Lines	58%	45%	39%
Commercial Lines:			
Trucking	17%	22%	36%
Commercial Auto	14%	17%	15%
Property (including Liability)	7%	11%	7%
Other Specialty Lines	4%	5%	3%
Total Commercial Lines	42%	55%	61%
Total Gross Premiums Written	100%	100%	100%

	2008	2007	2006
Geographical Area			
United States:			
California	10%	15%	14%
Florida	10%	10%	9%
Illinois	8%	9%	10%
Texas	5%	5%	6%
New Jersey	2%	2%	3%
New York	8%	7%	5%
Hawaii	5%	4%	3%
Other	22%	23%	19%
Total United States	70%	75%	69%
Canada:			
Ontario	17%	14%	20%
Alberta	3%	2%	4%
Québec	9%	7%	6%
Other	1%	2%	1%
Total Canada	30%	25%	31%
Total Gross Premiums Written	100%	100%	100%

NOTE 20 INDEBTEDNESS:

(a) Bank indebtedness:

On March 5, 2004, the Company entered into a C$150 million revolving credit facility with a syndicate of three banks. In December 2004 the facility was extended for a further 364 days and matured on March 3, 2006. The facility bore interest at a floating rate based on the type of loan and the Company's senior unsecured debt rating. The amount outstanding under this facility as at December 31, 2005 was $11,178,000, with an effective interest rate of approximately 5%.

On February 15, 2006, the Company entered into a C$150 million 364 day revolving credit facility with a syndicate of two banks that replaced the above facility. Depending on the type of loan, the facility bore interest at a floating rate based on the Company's senior unsecured debt rating. This facility was replaced on June 23, 2006.

On June 23, 2006, the Company entered into a new $175 million 3 year revolving facility with a syndicate of three banks. This new facility replaced the above C$150 million 364 day revolving credit facility and contains similar terms, conditions and financial covenants, compliance with which is reported quarterly. During 2008 the Company repaid all outstanding amounts under this facility. The amount outstanding under this facility at December 31, 2007 was $101,369,000 with an effective interest rate of 5.9%.

On December 21, 2007, the Company entered into a 365 day C$70 million credit facility with a syndicate of banks. This facility is supplemental to the existing $175 million credit facility above. During 2008 the Company repaid all outstanding amounts under this facility. The amount outstanding under this facility as at December 31, 2007 was $70,000,000 with an effective interest rate of 6.5%.

(b) Senior unsecured debentures:

On December 6, 2002, the Company issued C$78 million of 8.25% unsecured senior debentures with a maturity date of December 31, 2007. The debentures are redeemable prior to the maturity date, at the Company's option, upon at least 30 days notice to debenture holders. Interest on the debentures is payable semi-annually in arrears. The net proceeds to the Company were C$77,087,420. Interest payments were C$6,435,000 for each of the last three years. This debenture matured and was fully repaid as of December 31, 2007.

On January 29, 2004, a subsidiary of the Company, Kingsway America Inc., completed the sale of $100 million 7.50% senior notes due in 2014. The notes are fully and unconditionally guaranteed by the Company. The notes are redeemable at Kingsway America's option on or after February 1, 2009. In March 2004 an additional $25 million of these senior notes were issued. Interest payments were $9,375,000 for each of the last three years with an effective interest rate of 8.27%.

On July 10, 2007, a general partnership of the Company, Kingsway 2007 General Partnership, issued C$100 million of senior unsecured debentures at 6% due on July 11, 2012. These debentures bear interest at a fixed rate of 6% per annum payable semi-annually from the date of issuance until July 11, 2012. Interest payments are to be made on January 10 and July 10 of each year, commencing January 10, 2008 with an effective interest rate of 6.3%. The net proceeds to the Company amounted to C$99,188,000. Kingsway 2007 General Partnership may redeem the debentures in whole at any time and in part from time to time, at its option. The debentures are unconditionally guaranteed by Kingsway Financial and Kingsway America, a wholly-owned subsidiary of Kingsway Financial.

(c) Subordinated indebtedness:

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of the Company issued $90.5 million of 30 year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America Inc. to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the rate of the London interbank offered interest rate for three month U.S. dollar deposits, plus spreads ranging from 3.85% to 4.20%, but until dates ranging from December 4, 2007 to January 8, 2009, the interest rates will not exceed 12.45% to 12.75%. The

Company has the right to call each of these securities at par anytime after five years from their issuance until their maturity. The net proceeds to the Company were $70,877,000 after deducting expenses of $4,625,000. Interest paid during the year was $7,126,000, $8,896,000 for 2007 and $8,479,000 for 2006 with an effective weighted average interest rate of 9.85% for 2008.

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(d) Loans payable:

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.

Kingsway America Inc., a U.S. subsidiary has a promissory note payable balance of approximately $66.2 million with Kingsway ROC LLC, an affiliated Company. The note was issued on July 15, 2005 and bears interest at 7.37% annually. The note principal is payable on June 30, 2015. Interest paid during the year was $4,881,000 and $4,881,000 for 2007 with an effective interest rate of 7.37% for 2008.

(e) Contractual obligations:

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

	2008	2007
Bank indebtedness	$ -	$ 172,436
Senior unsecured debentures	185,203	220,080
Subordinated indebtedness	87,383	87,354
Loan payable	66,222	66,222
Total	$ 338,808	$ 546,092

Refer to Note 8 for a maturity schedule of these contractual obligations.

NOTE 21 VARIABLE INTEREST ENTITIES:

Variable interest entities include entities where the equity invested in the entity is considered insufficient to finance the entity's activities. The Company has controlled entities which are variable interest entities and two such entities are not consolidated based on accounting standards as the Company is not considered to be the primary beneficiary. The Company accounts for its investment in these entities using the equity method and includes the investment in other assets on the Consolidated Balance Sheet. The Company's share of earnings in these entities is included in net investment income in the Consolidated Statement of Operations. As the funds invested in this non-consolidated affiliated entity formed part of the C$74.1 million note referred to in Note 20(d), the effect of this transaction is to show additional debt on the Company's financial statements and an offsetting equity investment of C$8.3 million in the non-consolidated affiliated entity.

NOTE 22 COMMITMENTS AND CONTINGENT LIABILITIES:

(a) Legal proceedings:

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

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(b) Letters of credit:

On October 4, 2002 the Company entered into an annually renewable syndicated $350 million letter of credit facility which was renewed on November 10, 2008 at a lower value of $300 million. The letter of credit facility is principally used to collateralize inter-Company reinsurance balances for statutory capital management purposes. The Company pledges securities to collateralize the utilized portion of the letter of credit facility. At December 31, 2008 the letter of credit facility utilization was $261.2 million (2007 - $270.9 million).

(c) Charitable donations:

In 2004 the Company agreed to make a gift contribution of C$3 million to the Trillium Health Centre Foundation to be payable in equal instalments over the period of six years beginning in 2005. This contribution is being used to operate the Kingsway Financial Spine Centre in Mississauga, Ontario and is expensed as paid.

(d) Guarantees:

The Company provided a guarantee for the payment of principal and interest for a non-controlled affiliated entity which entered into a cross-currency swap transaction on July 14, 2005 in conjunction with the Kingsway Linked Return of Capital Trust transaction described in Note 20(d) whereby the affiliate swapped fixed Canadian dollar payments for fixed U.S. dollar payments. The guarantee extends until the swap agreement terminates on June 30, 2015.

(e) Collateral pledged:

As at December 31, 2008, bonds and term deposits with an estimated fair value of $54.1 million (2007 - $48.1 million) were on deposit with state and provincial regulatory authorities. Also, from time to time, the Company pledges securities to third parties to collateralize liabilities incurred under its policies of insurance. At December 31, 2008, the amount of such pledged securities was $109.9 million (2007 - $39.1 million). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company’s standard risk management controls.

(f) Collateral held:

In the normal course of business, the Company receives collateral on certain business transactions to reduce its exposure to credit risk. As at December 31, 2008, the amount of such pledged securities was $ 0.7 million (2007 - $0.2 million). The Company is normally permitted to sell or repledge the collateral it receives under terms that are common and customary to standard collateral holding and are subject to the Company’s standard risk management controls.

(g) Future minimum lease payments:

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

2009	$	4,140
2010		3,740

2011	3,152
2012	2,855
2013	2,360
Thereafter	7,200

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NOTE 23 GOODWILL AND OTHER INTANGIBLE ASSETS:

(a) Goodwill:

Goodwill is assessed for impairment on an annual basis and at any other time if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting segment below its carrying amount.

Any potential impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting segment exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting segment exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting segment level, the carrying value of goodwill exceeds the implied fair value.

The Company determines the fair value using a discounted cash flow model corroborated by other valuation techniques such as market multiples. The process of determining these fair values requires management to make estimates and assumptions including, but not limited to projected future revenue, earnings, discount rates and terminal growth rates.

In 2008, the Company performed the annual goodwill impairment test and it was determined that the carrying amount of goodwill for the U.S. Reporting Segment exceeded its fair value. As a result, the Company recorded in operating income a non-cash goodwill impairment charge of $62,876,000 relating to this goodwill. The determination that the fair value of goodwill was less than its carrying value resulted from a decline in market multiples, both from an industry and Company perspective, and a reduction of fair value as determined using the discounted cash flow methodology, incorporating both current Company and market assumptions, which in combination resulted in the goodwill impairment.

The following table discloses the changes in goodwill over 2008 and 2007:

	2008	2007
Balance, beginning of year	$ 72,106	69,030
Acquisitions	-	1,562
Dispositions	(1,673)	-
Impairment	(62,876)	-
Effects of foreign exchange	(1,561)	1,514
Balance, end of year	5,996	72,106

(b) Intangibles:

The intangible assets with indefinite useful lives for 2008 were $10,053,000 (2007 - $10,053,000). The intangible assets with definite useful lives net of accumulated amortization for 2008 were $29,728,000 (2007 - $34,615,000). Amortization of intangible assets for 2008 was $4,887,000 (2007 - $4,007,000 and 2006 - $1,030,000). There is no write-down of intangible assets due to impairment for the years 2008, 2007 and 2006.

NOTE 24 RECONCILIATION OF CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES:

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

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

		2008		2007		2006
Net income (loss) based on Canadian GAAP	$	(405,865)	$	(18,526)	$	123,309
Impact on net income of U.S. GAAP adjustments, net of tax:		-		-		-
Net income based on U.S. GAAP*	$	(405,865)	$	(18,526)	$	123,309

		2008		2007		2006
Comprehensive income (loss) based on Canadian GAAP	$	(468,858)	$	42,657	$	120,362
Change in unrealized gain on securities classified as available-for-sale		-		-		8,271
Less: related future income taxes		-		-		(1,194)
Other comprehensive income adjustments		-		-		9,465
Total comprehensive income (loss) based on U.S. GAAP	$	(468,858)	$	42,657	$	129,827
*Basic earnings (loss) per share based on U.S. GAAP net income	$	(7.35)	$	(0.33)	$	2.19
*Diluted earnings (loss) per share based on U.S. GAAP net income	$	(7.35)	$	(0.33)	$	2.17

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

		2008	2007
Shareholders’ equity based on Canadian GAAP	$	453,572	$940,801
Other comprehensive income		-	-
Cumulative net income impact:			
Other		-	(821)
Shareholders’ equity based on U.S. GAAP	$	453,572	$939,980

The consolidated statements are prepared in accordance with Canadian GAAP. As required by the U.S. Securities and Exchange Commission (SEC), material differences between Canadian and U.S. GAAP are quantified and described below. Effective January 1, 2007, Canadian GAAP has conformed to U.S. GAAP relating to disclosures of other comprehensive income in the financial statements and accumulated balances of other comprehensive income or loss in the equity section of the Company’s consolidated balance sheet. As a result, in the current year there are no reconciling items between Canadian and U.S. GAAP as reported by the Company for 2007. Total cumulative other comprehensive income amounted to $22,873,000 and $85,866,000 as at December 31, 2008 and 2007, respectively.

(a) Securities:

As described in Note 3, effective January 1, 2007, Canadian GAAP became substantially consistent with U.S. GAAP for the Company’s activities relating to the accounting for securities. Under the adoption of these new standards, the

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

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b) Income taxes:

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

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

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

The adoption of FIN 48, had no impact on the opening retained earnings under U.S. GAAP. As of December 31, 2008, the Company had no unrecognized tax benefits. The Company analyzed its tax positions in accordance with the provisions of FIN 48 and has determined that there are no uncertain tax positions. It is difficult to project how unrecognized tax benefits will change over the next 12 months. The Company operates in Canada, the U.S. and other foreign jurisdictions, subject to examination by tax authorities.

c) Future accounting pronouncements:

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. The statement is intended to enhance the current disclosure framework in Statement 133, Accounting for Derivative Instruments and Hedging Activities. The requirements of this statement will be effective for the Company beginning January 1, 2009.

NOTE 25 COMPARATIVE FIGURES:

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

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NOTE 26 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION:

In 2004, Kingsway America Inc. ("KAI") issued $125 million 7.5% senior notes due in 2014 through a private offering. These notes are redeemable at KAI's option on or after February 1, 2009 and are fully and unconditionally guaranteed by the Company. On July 10, 2007, the Company through its newly formed wholly-owned subsidiary Kingsway 2007 General Partnership ("K2007GP") issued C$100 million 6% senior unsecured debentures with a maturity date of July 11, 2012, unconditionally guaranteed by Kingsway Financial Services Inc. ("KFSI") and KAI, another wholly-owned subsidiary (each a "Guarantor"). The debentures will be redeemable, in whole or part, at the option of K2007GP and are not subject to repayment by the holders prior to maturity. Interest on the debentures is payable semi-annually in arrears in equal instalments on January 10 and July 10 each year beginning January 10, 2008. The following tables show condensed consolidating financial information for the Company as of December 31, 2008 and 2007 and for the three years ended December 31, 2008, 2007 and 2006, with a separate column for each Guarantor, the issuer and the other businesses of the Company combined ("Non-Guarantor subsidiaries").

Condensed Consolidating Statement of Operations
For the year ended December 31, 2008

	KFSI (a "Guarantor")	KAI (an "Issuer" and a "Guarantor")	K2007GP (an "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Revenue:						
Net premiums earned	$ -	$ -	$ -	$ 1,509,427	$ (25,164)	$ 1,484,263
Investment related income (loss)	488	3,651	6,953	(27,263)	7,502	(8,669)
Management fees	97,848	19,829	-	-	(117,677)	-
	98,336	23,480	6,953	1,482,164	(135,339)	1,475,594
Expenses:						
Claims incurred	-	-	-	1,238,245	(32,635)	1,205,610
Commissions and premium taxes	-	-	-	266,594	-	266,594
Other expenses	83,603	28,920	237	307,111	(95,625)	324,246
Interest expense	3,928	28,240	6,195	3,738	(7,079)	35,022
	87,531	57,160	6,432	1,815,688	(135,339)	1,831,472
Income (loss) before income taxes	10,805	(33,680)	521	(333,524)	-	(355,878)
Income taxes	2,960	(15,998)	177	86,235	-	73,374
Income (loss) from continuing operations	7,845	(17,682)	344	(419,759)	-	(429,252)
	41,411	-	-	(18,024)	-	23,387

Income (loss) from discontinued operations						
Equity in undistributed net income of subsidiaries	(455,121)	(310,395)	-	-	765,516	-
Net income	$ (405,865)	$ (328,077)	$ 344	$ (437,783)	$ 765,516	$ (405,865)

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Condensed Consolidating Statement of Operations For the year ended December 31, 2007	KFSI (a “Guarantor”)	KAI (an “Issuer” and a “Guarantor”)	K2007GP (an “Issuer”)	Other subsidiaries (the “Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Revenue:						
Net premiums earned	$ -	$ -	$ -	$ 1,714,006	$ -	$ 1,714,006
Investment related income	(1,390)	4,860	6,199	176,631	2,026	188,326
Management fees	83,553	13,512	-	-	(97,065)	-
	82,163	18,372	6,199	1,890,637	(95,039)	1,902,332
Expenses:						
Claims incurred	-	-	-	1,606,693	(247,610)	1,359,083
Commissions and premium taxes	449	-	-	307,384	-	307,833
Other expenses	81,466	21,409	93	(24,027)	152,571	231,512
Interest expense	8,605	26,540	2,994	728	-	38,867
	90,520	47,949	3,087	1,890,778	(95,039)	1,937,295
Income (loss) before income taxes	(8,357)	(29,577)	3,112	(141)	-	(34,963)
Income taxes	14,168	10,398	1,058	(29,774)	-	(4,150)
Income (loss) from continuing operations	(22,525)	(39,975)	2,054	29,633		(30,813)
Income (loss) from discontinued operations	-	-	-	12,287		12,287
Equity in undistributed net income of subsidiaries	3,999	(108,273)	-	-	104,274	-
Net income	$ (18,526)	$ (148,248)	$ 2,054	$ 41,920	$ 104,474	$ (18,526)

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Condensed Consolidating Statement of Operations
For the year ended December 31, 2006

	KFSI (the "Guarantor")	KAI (the "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Revenue:					
Net premiums earned	$ -	$ -	$ 1,601,994	$ -	$ 1,601,994
Investment related income	(603)	3,746	140,868	-	144,011
Management fees	70,439	13,464	-	(83,903)	-
	69,836	17,210	1,742,862	(83,903)	1,746,005
Expenses:					
Claims incurred	-	-	1,146,156	(21,245)	1,124,911
Commissions and premium taxes	(391)	-	297,416	-	297,025
Other expenses	62,143	23,338	143,082	(62,658)	165,905
Interest expense	7,161	22,870	216	-	30,247
	68,913	46,208	1,586,870	(83,903)	1,618,088
Income (loss) before income taxes	923	(28,998)	155,992	-	127,917
Income taxes	9,360	(9,854)	15,471	-	14,977
Income (loss) from continuing operations	(8,437)	(19,144)	140,521		112,940
Income (loss) from discontinued operations			10,369		10,369
Equity in undistributed net income of subsidiaries	131,746	(13,543)	-	(118,203)	-
Net income	$ 123,309	$ (32,687)	$ 150,890	$ (118,203)	$ 123,309

Condensed Consolidating Balance Sheets
As at December 31, 2008

	KFSI (a "Guarantor")	KAI (an "Issuer" and a "Guarantor")	K2007GP (an "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Assets						
Investments in subsidiaries	$ 409,577	$ 743,825	$ -	$(1,470,854)	$ 317,452	-
Cash	21,335	5,603	543	78,175	-	105,656
Investments	-	-	-	2,449,194	(17,093)	2,432,101

Goodwill and other intangible assets	5,996	-	-	39,782	-	45,778
Other assets	21,447	80,769	113,520	2,484,402	(1,940,232)	759,906
	$ 458,355	$ 830,197	$ 114,062	$ 3,580,699	$(1,639,873)	$3,343,441
Liabilities and Shareholders' Equity						
Liabilities:						
Bank indebtedness	$ -	$ 170,175	$ -	$ -	$ (103,953)	$ 66,222
Other liabilities	4,784	30,652	16,818	(36,642)	119,953	135,565
Unearned premiums	-	-	-	823,071	(286,591)	536,480
Unpaid						