KINGSWAY FINANCIAL SERVICES INC
Form 40-F
March 28, 2008

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, 2007 Commission File Number: 1-15212

KINGSWAY FINANCIAL SERVICES INC.

(Exact name of Registrant as specified in its charter)

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

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

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

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

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

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

Title of each class	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 issuer's classes of capital or common stock as of the close of the period covered by the annual report.

55,515,728 Common Shares outstanding as of December 31, 2007

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

Yes _______ 82- _______ No 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 ______

KINGSWAY FINANCIAL SERVICES INC.

DOCUMENTS FILED UNDER COVER OF THIS FORM

Document No. 1

KINGSWAY FINANCIAL SERVICES INC.

2007 ANNUAL INFORMATION FORM

March 28, 2008

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1. INCORPORATION

Kingsway Financial Services Inc. ("KFSI" "Kingsway" or the "Company") 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.

2. 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 2 (a) to the consolidated financial statements of KFSI (the "Consolidated Financial Statements") contained in KFSI's 2007 Annual Report (the "Annual Report") which is incorporated herein by reference. All subsidiaries are 100% owned, directly or indirectly (except for qualifying shares of York Fire & Casualty Insurance Company and Kingsway General Insurance Company held by directors in order to satisfy applicable statutory requirements).

3. 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, Kingsway General Insurance Company ("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. Since KFSI's initial public offering in 1995, KFSI has made selective acquisitions in Canada and the United States, including its insurance subsidiaries, American Service Insurance Company, Inc., U.S. Security Insurance Company, Jevco Insurance Company ("Jevco"), Southern United Fire Insurance Company, Universal Casualty Company, Lincoln General Insurance Company ("Lincoln"), York Fire & Casualty Insurance Company, American Country Insurance Company, Zephyr Insurance Company Inc. ("Zephyr"), Mendota Insurance Company and its wholly owned subsidiary Mendakota Insurance Company (collectively, "Mendota"). In 1998, KFSI established Avalon Risk Management Inc. to act as an insurance intermediary for specialty lines such as cargo insurance, surety bonds and other insurance coverage for the logistics industry. In addition, insurance subsidiaries have developed specific books of business by entering into contracts with program managers. All of the dollar amounts are expressed in U. S. dollars, except where otherwise indicated. References to C$ are to Canadian dollars.

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

(a) the completion in July 2005 of the public offering of C$78 million of 5.00% Kingsway Linked Return of Capital Preferred Units ("LROC Preferred Units") due June 30, 2015, the net proceeds of which were used for a series of investments that included the purchase of an approximately C$74.1 million 7.12% senior notes due June 30, 2015 issued by an affiliate of KFSI;

(b) the closing in October 2005 of the acquisition of HI Holdings, Inc. ("HI") for $24.6 million, which included HI's wholly owned subsidiary, Zephyr;

(c) the completion in November 2005 of a program management agreement between Lincoln and The Robert Plan Corporation ("RPC"), which provided that Lincoln would assume the risk relating to assigned risk obligations acquired from other insurers, and in 2006 and early 2007, the subsequent purchase of the renewal rights of the RPC's assigned risk business for approximately $35.0 million;

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

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

(f) 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 $99,188,000. The debentures are jointly and severally guaranteed by KFSI and Kingsway America Inc. ("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;

(g) 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; and

(h) the entering into in December 2007 of a 365 day C$70 million credit facility agreement, which supplements the existing $175 million that matures in June 2009.

4. NARRATIVE DESCRIPTION OF THE BUSINESS

In 2007, non-standard automobile business became the largest business line for KFSI and accounted for 31% of KFSI's $1.96 billion of gross premiums written ("GPW") (GPW being the total premiums on insurance underwritten before deduction of reinsurance premiums ceded) in 2007. Non-standard automobile insurance is the insuring of automobile risks for drivers with worse than average driving records primarily as a result of accidents or traffic violations.

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 21% of KFSI's GPW in 2007.

KFSI's premium distribution by line and geographic areas is set out in Note 14 to the Consolidated Financial Statements, which Note is incorporated herein by reference.

In addition to revenue derived from premiums earned, KFSI also derives revenue from premium financing and investment income. This revenue amounted to $193.6 million in 2007 as compared to $149.9 million in 2006.

The selected Supplemental Financial Information set out on page 86 of the Annual Report, which section is incorporated herein by reference, provides details of the GPW, underwriting profits, and key ratios from KFSI's insurance operations compared to industry results for the eight year period ending December 31, 2007.

Employees

As at December 31, 2007, KFSI employed an aggregate of approximately 2,900 personnel, none of whom are unionized. We believe our relationship with our employees is good.

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 and internally generated net income. KFSI's operations create liquidity by collecting and investing premiums, as more fully discussed on page 39 of the Annual Report, which section is incorporated herein by reference.

Investment Portfolio

The fair value of KFSI's securities portfolio increased 14% to $3.51 billion as at December 31, 2007 from $3.09 billion as at December 31, 2006. Total returns on a pre-tax basis were 6.1% for the year compared with 5.2% for 2006. The investment portfolio as at December 31, 2007 and December 31, 2006 is comprised of assets from a number of different classes as reflected in Note 4 to the Consolidated Financial Statements set out on pages 71 to 72 of the Annual Report, which section is incorporated herein by reference.

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 13 of the last 18 years.

During 2007, KFSI increased its GPW 2% to $1.96 billion compared to $1.93 billion in 2006. The increases came primarily from the acquisition of Mendota and the impact of currency exchange rates. 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 2007, Kingsway's combined ratio from Canadian and U.S. Operations was 95.0% and 115.3%, respectively, compared with the industry averages of 92.4% and 95.6%, respectively.

5. RISK FACTORS

The risks faced by KFSI are described on pages 47 to 56 of the Annual Report and this section is incorporated herein by reference.

6. DIVIDEND POLICY

The ability of KFSI to pay dividends 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$0.26 per share and C$0.20 per share for the fiscal years ended December 31, 2007, 2006 and 2005, respectively. KFSI has declared a quarterly dividend of C$0.075 per share payable on March 31, 2008. 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.

7. DESCRIPTION OF CAPITAL STRUCTURE

(a) 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 17, 2008, 55,334,528 common shares were outstanding. All common shares have the same attributes, including the right to one vote per share.

On November 3, 2005, KFSI announced its intention to commence a normal course issuer bid ("NCIB") to repurchase up to 2,823,000 common shares of the Company, being approximately five percent of the total number of common shares then outstanding. Purchases were eligible to commence on November 8, 2005 and end no later than November 7, 2006. During this period, 562,800 common shares were repurchased at an average price of C$22.13. On November 7, 2006, KFSI announced its intention to commence another 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. For the period November 13, 2007 to December 31, 2007, KFSI had repurchased 123,700 of its common shares at an average price of C$16.14. For the year ended December 31, 2007, 445,100 common shares had been repurchased at an average price of C$20.35.

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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 our 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.

(b) 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 will be redeemable at Kingsway America's option on or after 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 until dates ranging from December 4, 2007 to January 8, 2009, the interest rates will 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.

In July 2005, in connection with the offering of LROC Preferred Units, an affiliate of KFSI issued an unsecured senior note in the principal amount of C$74.1 million. This note bears interest at the rate of 7.12% per annum and mature on June 30, 2015.

In July 2007, Kingsway GP, a subsidiary of KFSI, issued C$100,000,000 principal amount of 6% senior unsecured debentures. These debentures bear interest at the rate of 6% per annum and mature on July 11, 2012.

(c) Ratings

The ratings received from rating organizations for securities of KFSI are described on page 43 of the Annual Report and this section is incorporated herein by reference.

8. MARKET FOR SECURITIES

(a) 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 for the periods indicated in Canadian dollars:

Month	High	Low	Volume
January 2007	25.45	23.43	2,797,000
February 2007	26.07	21.56	7,317,000
March 2007	22.65	20.21	5,112,800
April 2007	24.37	21.44	3,130,000
May 2007	23.15	19.62	5,513,300
June 2007	20.72	19.69	3,567,800
July 2007	20.15	18.72	2,485,000
August 2007	20.75	17.75	3,614,300
September 2007	19.65	18.27	2,167,400
October 2007	19.80	17.56	3,876,900
November 2007	19.87	15.53	4,242,000
December 2007	16.15	10.77	5,908,700

(b) Prior Sales

No common shares of KFSI were issued during the fiscal year ending December 31, 2007 except for 76,303 common shares issued on the exercise of options granted pursuant to KFSI's Amended and Restated Stock Option Plan.

9. DIRECTORS AND OFFICERS

(a) Name, Occupation and Security Holding

The following table and the notes thereto state 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 of the Company beneficially owned, directly or indirectly, by each of them, or over which they exert control or direction as of March 17, 2008. 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 17, 2008, which section is incorporated herein by reference.

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(1)	President and Chief Executive Officer, KFSI	106,637	421,000
Shelly Gobin Mississauga, ON(2)	Vice President and Chief Financial Officer, KFSI	75,061	52,500
Frank Amodeo Toronto, ON	Vice President, KFSI	9,204	47,500
Denis Cloutier Newmarket, ON	Vice President and Chief Actuary - Canadian Operations, KFSI	1,772	32,500
Dennis Fielding Pickering, ON	Vice President, KFSI	6,180	50,500
Anastassia Plitman Maple, ON	Vice President, Internal Audit, KFSI	230	4,500
Tom Mallozzi Brampton, ON	Vice President, Underwriting, KFSI	794	19,500
Claude Smith Cambridge, ON	Vice President and Chief Information Officer, KFSI	4,148	48,500
		1,407	20,500

Andrew Wright Toronto, ON	Vice President, Reinsurance and Risk Management, KFSI		
Kathleen Howie Oakville, ON	Assistance Vice President and Chief Legal Counsel, KFSI	Nil	Nil

Notes:

(1) William G. Star retired as President and Chief Executive Officer of KFSI effective December 31, 2007. Mr. Jackson was appointed as President and Chief Executive Officer of KFSI effective January 1, 2008.

(2) W. Shaun Jackson was KFSI's Executive Vice President and Chief Financial Officer until December 31, 2007, when he was appointed as KFSI's President and Chief Executive Officer. Ms. Gobin was appointed as Vice President and Chief Financial Officer effective January 11, 2008.

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

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.

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.

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.

Kathleen Howie joined KFSI in December 2007. Prior thereto, Ms. Howie was formally in 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.

Except as noted above, 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.

As a group, the directors and officers of KFSI own, directly or indirectly or exercise control or direction over 312,843 (0.57%) of the total outstanding common shares of KFSI. 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 officers of KFSI.

The Company does not have an Executive Committee. In 2007, Mr. Walsh served as KFSI's Lead Director. The Board of Directors (the "Board") has established an Audit Committee comprised solely of outside Directors, namely Messrs. Atkins, Di Giacomo, Farnam and Walsh. In addition, the Board has established a Nominating Committee comprised of Messrs. Atkins, Walsh, Reeve and Sullivan, a Compensation and Management Resources Committee comprised of Messrs. Farnam, Di Giacomo, Beamish and Gillespie and an Investment Committee which in 2007 was comprised of Messrs. Di Giacomo, Star, Sullivan and Walsh. In 2008, it is expected that Mr. Jackson will be appointed to replace Mr. Star as a member of the Investment Committee. In 2007, the Board established a Special Committee, comprised of Messrs. Atkins, Di Giacomo, Reeve and Walsh.

(b) Cease Trade Order

Mr. Gillespie, a member of the Board of Directors since 2006, was a director of Atlas Cold Storage Income Trust during a time in which all of the directors were subject to a cease trade order as a result of failing to file quarterly financial reports within the time requirements mandated by Canadian securities laws. The cease trade order was lifted on May 11, 2004.

(c) 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.

10. 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.

11. INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

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 commissions of approximately $67,855 paid by a cruise ship operator to a corporation owned by the spouse of the former President and Chief Executive Officer of KFSI for an incentive cruise sponsored by KFSI for certain of its brokers.

12. AUDIT COMMITTEE INFORMATION

(a) Composition of the Audit Committee

The Audit Committee of KFSI is composed of the following four members: David H. Atkins, Thomas A. Di Giacomo, Walter E. Farnam and F. Michael Walsh. Mr. Farnam was appointed a member in February 2006. 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 the composition of the Audit Committee reflects a high level of financial literacy and expertise. Each member of the Audit Committee has been determined by the Board to be "independent" and "financially literate" as such terms are defined under Canadian and United States securities laws and the NYSE rules. 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 that is relevant to the performance of his or her responsibilities as a member of the Audit Committee:

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 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.

(b) Shareholders' Auditors' Service Fees

Aggregate fees paid to the Shareholders' Auditors during the fiscal years ended December 31, 2007 and 2006 were as follows:

(in Canadian dollars)	2007 Fee Amount	2006 Fee Amount
Audit Fees	$ 4,586,000	$ 4,237,000
Audit-related Fees	$ 74,000	$ 190,000
Tax Fees	$ 208,000	$ 162,000
All Other Fees	$ 2,000	$ 2,000
Total:	$ 4,870,000	$ 4,591,000

13. TRANSFER AGENT AND REGISTRAR

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

14. INTERESTS OF EXPERTS

(a) Names of Experts

KPMG LLP prepared auditors' reports in regard to the consolidated financial statements of KFSI for the fiscal year ending December 31, 2007 and in regard to the Company's internal control over financial reporting at December 31, 2007. 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, 2007. The Canadian Institute of Actuaries gives authority to the report.

(b) 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 Tillinghast, a 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.

15. 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, 2007, 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 17, 2008 in connection with its Annual Meeting of Shareholders to be held on May 8, 2008, which involves the election of directors.

Copies of the Annual Information Form, as well as copies of the 2007 Annual Report of KFSI for the year ended December 31, 2007 and Proxy Circular dated March 17, 2008 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

I. Purpose

The Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to (a) the integrity of the Company's financial statements, (b) the Company's compliance with legal and regulatory requirements, (c) the external auditor's qualifications and independence, and (d) the performance of the Company's 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 members of the Committee shall be financially literate, being defined as able to read and understand basic financial statements, and the Chair of the Committee shall have accounting or related financial management expertise. The Audit Committee shall assist the Board in determining whether or not one or more members of the Audit Committee is an "audit committee financial expert" as defined in SEC 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 Chair 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 fulfil 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 by the Board of Directors of 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.

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 not 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 auditors' independence.

11. Review the external auditors' audit plan and in particular, discuss and approve audit scope, 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 ramifications of the use of such alternative disclosures and treatments; and the treatment preferred by the 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 auditors' 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.

Internal Audit Department and Legal Compliance

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 procedures and any material issues raised by the most recent internal quality-control review, or peer review of the Company.

19. Review significant internal audit reports together with management's response and follow-up to these reports.

20. Meet separately, periodically, with management, with internal auditors and with external auditors.

21. Review formal whistleblower procedures that address the receipt, retention and treatment of complaints regarding accounting, internal controls and auditing matters and the confidential anonymous submission by employees of any concerns regarding questionable accounting or auditing matters.

22. On at least an annual basis, review with the Company's counsel any legal matters that could have a significant impact on the organization's financial statements, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.

23. Develop and recommend to the full Board a set of corporate governance principles, review such principles annually and recommend any modifications thereto.

24. Consider corporate governance issues that may arise from time to time and make recommendations to the Board with respect thereto.

25. Confer, as appropriate, with the General Counsel on matters of corporate governance.

Other Audit Committee Responsibilities

26. Annually assess the effectiveness of the committee against this Mandate and report the results of the assessment to the Board

27. Perform any other activities consistent with this Mandate, the Company's by-laws and governing law, as the Committee or the Board deems necessary or appropriate.

28. Maintain minutes of meetings and periodically report to the Board of Directors on significant results of the foregoing activities.

29. Establish, review, and update periodically a Code of Ethics for the CEO and other Senior Financial Officers and Code of Business Conduct and Ethics for others and ensure that management has established a system to enforce these Codes.

30. The Audit Committee will annually review a summary of director and officers' related party transactions and potential conflicts of interest.

December 2007

Document No. 2

Consolidated Financial Statements of

KINGSWAY FINANCIAL SERVICES INC.

As at December 31, 2007 and 2006

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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") 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 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 securities regulators, 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.

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 external auditors.

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 external auditors 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 in 2006 and 2007 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. The shareholders' auditors have 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.

W. Shaun Jackson
President & Chief Executive Officer

Shelly Gobin
Vice President & Chief Financial Officer

March 28, 2008

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, 2007, which is a recognized and suitable framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections or 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.

During 2007 the Company acquired Mendota Insurance Company and its wholly owned subsidiaries, Mendakota Insurance Company and Mendota Insurance Agency ("Mendota companies"). Due to the timing of this acquisition, Management has excluded from its assessment of effectiveness the Mendota companies internal control over financial reporting associated with total assets of $160 million (or 3.4% of total assets) and total revenues of $129 million (or 6.3% of total revenues) included in the consolidated financial statements for the Company as of and for the year ended December 31, 2007.

Except for the exclusion as noted in the preceding paragraph, Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007 and has concluded that such internal control over financial reporting is effective as of December 31, 2007.

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.

W. Shaun Jackson	Shelly Gobin
President & Chief Executive Officer	Vice President & Chief Financial Officer

March 28, 2008

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, 2007, 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 preventionor 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, 2007, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Kingsway Financial Services Inc. acquired Mendota Insurance Company and Mendakota Insurance Company ("Mendota Companies") during 2007, and management excluded from its assessment of the effectiveness of Kingsway Financial Services Inc.'s internal control over financial reporting as of December 31, 2007, Mendota Companies' internal control over financial reporting associated with total assets of $160 million (or 3.4% of total assets) and total revenues of $129 million (or 6.3% of total revenues) included in the consolidated financial statements of Kingsway Financial Services Inc. as of and for the year ended December 31, 2007. Our audit of internal control over financial reporting of Kingsway Financial Services Inc. also excluded an evaluation of the internal control over financial reporting of Mendota Companies.

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, 2007, we also have conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our report dated March 28, 2008 expressed an unqualified opinion on those consolidated financial statements.

Chartered Accountants,
Licensed Public Accountants
Toronto, Canada
March 28, 2008

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, 2007 and December 31, 2006 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, 2007. 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, 2007 and 2006, 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 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, 2007 and December 31, 2006 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007 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 19 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, 2007, 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 28, 2008 expressed an unqualified opinion on the effectiveness of, the Company's internal control over financial reporting.

Chartered Accountants,
Licensed Public Accountants
Toronto, Canada
March 28, 2008

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, 2007 and 2006 and their changes in the consolidated statement of operations for the years then ended in accordance with Canadian accepted actuarial practice.

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

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

Pierre Laurin, Towers Perrin Inc.

Fellow Canadian Institute of Actuaries
March 28, 2008

CONSOLIDATED BALANCE SHEETS
(In thousands of U.S. dollars)

As at December 31

	2007	2006
Assets		
Cash and cash equivalents	$ 161,635	$ 129,706
Securities (Note 4)	3,256,365	2,861,562
Accrued investment income	33,186	28,365
Financed premiums	91,851	67,528
Accounts receivable and other assets	365,410	318,332
Due from reinsurers and other insurers (Note 10)	207,137	208,090
Deferred policy acquisition costs	176,202	158,527
Income taxes recoverable	1,348	2,017
Future income taxes (Note 11)	114,066	75,212
Capital assets (Note 6)	133,431	108,149
Goodwill and intangible assets (Notes 2(e), 13(a), (b) & (c))	116,774	90,850
	$ 4,657,405	$ 4,048,338
Liabilities and Shareholders' Equity		
Liabilities:		
Bank indebtedness (Note 15(a))	$ 172,436	$ 52,149
Loans payable (Note 15(d))	66,222	66,222
Accounts payable and accrued liabilities	144,940	124,760
Unearned premiums	758,490	682,452
Unpaid claims (Note 12)	2,267,082	1,939,363
Senior unsecured debentures (Note 15(b))	220,080	191,930
Subordinated indebtedness (Note 15(c))	87,354	90,500
	$ 3,716,604	$ 3,147,376
Shareholders' equity:		
Share capital (Note 7)	326,151	328,473
Contributed surplus	7,619	5,352
Retained earnings	521,165	560,126
Accumulated other comprehensive income (Notes 1 and 2(c))	85,866	7,011
	940,801	900,962
Contingent liabilities (Note 17)		
	$ 4,657,405	$ 4,048,338

See accompanying notes to consolidated financial statements.

On behalf of the Board:

F. Michael Walsh
Director

David H. Atkins
Director

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

Years ended December 31

		2007		2006		2005
Gross premiums written	$	1,962,740	$	1,932,750	$	1,894,660
Net premiums written	$	1,818,902	$	1,803,382	$	1,824,393
Revenue:						
Net premiums earned (Note 10)	$	1,842,118	$	1,766,497	$	1,791,943
Net investment income (Note 4)		141,456		120,871		93,035
Net realized gains (Note 4)		52,111		28,987		38,239
		2,035,685		1,916,355		1,923,217
Expenses:						
Claims incurred (Notes 10 and 12)		1,436,340		1,234,525		1,224,506
Commissions and premium taxes (Note 10)		334,800		328,443		361,875
General and administrative expenses		243,082		182,256		155,773
Interest expense		38,867		30,247		25,921
Amortization of intangible assets		4,007		1,030		795
		2,057,096		1,776,501		1,768,870
Income (loss) before income taxes		(21,411)		139,854		154,347
Income taxes (recovery) (Note 11):						
Current		34,587		33,160		28,208
Future		(37,472)		(16,615)		(8,869)
		(2,885)		16,545		19,339
Net income (loss)	$	(18,526)	$	123,309	$	135,008
(Loss) earnings per share (in dollars) (Note 7):						
Basic	$	(0.33)	$	2.19	$	2.39
Diluted	$	(0.33)	$	2.17	$	2.37
Dividends declared per common share (in dollars)	C$	0.30	C$	0.26	C$	0.20

See accompanying notes to consolidated financial statements.

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

Years ended December 31

	2007	2006	2005
Share capital			
Balance at beginning of year	$ 328,473	$ 331,470	$ 328,544
Issued during the year	1,082	3,004	2,926
Repurchased for cancellation	(3,404)	(6,001)	-
Balance at end of year	326,151	328,473	331,470
Contributed surplus			
Balance at beginning of year	$ 5,352	$ 3,237	$ 1,769
Stock option expense	2,267	2,115	1,468
Balance at end of year	7,619	5,352	3,237
Retained earnings			
Balance at beginning of year	$ 560,126	$ 460,050	$ 334,468
Net income (loss) for the year	(18,526)	123,309	135,008
Common share dividends	(15,710)	(12,988)	(9,426)
Repurchase of shares for cancellation	(4,725)	(10,245)	-
Balance at end of year	521,165	560,126	460,050
Accumulated other comprehensive income			
Balance at beginning of year	$ 7,011	$ 9,958	$ 1,720
Cumulative effect of adopting new accounting policies (Note 1)	17,672	-	-
Other comprehensive income (loss) (Notes 1 and 2(c))	61,183	(2,947)	8,238
Balance at end of year	85,866	7,011	9,958
Total shareholders' equity at end of year	$ 940,801	$ 900,962	$ 804,715

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

Years ended December 31

	2007	2006	2005
Comprehensive income			
Net income (loss)	$ (18,526)	$ 123,309	$ 135,008
Other comprehensive income (loss), net of taxes:			
• Change in unrealized gains on available-for-sale securities:			
Unrealized gains arising during the year, net of income taxes1	19,885	-	-
Reclassification to net income (loss) of realized gains, net of income taxes 2	(13,312)	-	-
• Unrealized gains (losses) on translating financial statement of self-sustaining foreign operations	54,610	(2,947)	8,238
Other comprehensive income (loss)	61,183	(2,947)	8,238
Comprehensive income	$ 42,657	$ 120,362	$ 143,246

(1) Net of income tax of $803
(2) Net of income tax of $5,100

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31 (in thousands of U.S. dollars)

Years ended December 31	2007	2006	2005
Cash provided by (used in):			
Operating activities:			
Net income (loss)	$ (18,526)	$ 123,309	$ 135,008
Items not affecting cash:			
Amortization of intangibles	4,007	1,030	795
Amortization of capital assets and deferred charges	11,535	6,598	6,884
Future income taxes	(36,271)	(17,362)	(6,924)
Net realized gains	(52,111)	(28,987)	(38,239)
Amortization of bond premiums and discounts	(7,951)	(2,667)	10,825
	(99,317)	81,921	108,349
Change in non-cash balances:			
Deferred policy acquisition costs	(17,307)	(9,801)	(2,868)
Due from reinsurers and other insurers	(177,024)	29,266	34,713
Decrease in funds withheld payable to reinsurer	-	-	(78,691)
Unearned premiums	35,918	34,037	(10,386)
Unpaid claims	291,254	95,036	149,891
Increase in contributed surplus	2,267	2,115	1,468
Net change in other non-cash balances	31,295	(65,345)	71,271
	67,086	167,229	273,747
Financing activities:			
Increase in share capital, net	1,082	3,004	2,926
Repurchase of common shares for cancellation	(8,129)	(16,246)	-
Common share dividend	(15,710)	(12,988)	(9,426)
Increase in bank indebtedness and loans payable	111,776	40,845	17,378
Increase in senior unsecured debentures	17,274	-	-
	106,293	14,615	10,878
Investing activities:			
Purchase of securities	(4,135,457)	(3,279,985)	(2,590,018)
Proceeds from sale of securities	4,074,167	3,164,215	2,356,581
Financed premiums receivable, net	(14,440)	18,369	3,973
Acquisitions (Note 13)	(44,721)	(22,415)	(11,892)
Additions to capital assets	(20,999)	(43,356)	(19,338)
	(141,450)	(163,172)	(260,694)
Increase in cash position during the year	31,929	18,672	23,931
Cash and cash equivalents, beginning of year	129,706	111,034	87,103
Cash and cash equivalents, end of year	$ 161,635	$ 129,706	$ 111,034
Supplementary disclosure of cash information:			
Represented by:			
Cash on hand and balances with banks	147,478	126,887	100,290
Investments with maturities less than 30 days	14,157	2,819	10,744
Cash and cash equivalents, end of year	$ 161,635	$ 129,706	$ 111,034
Cash paid for:			
Interest	$ 36,242	$ 30,170	$ 25,474
Income taxes	38,894	45,659	13,141

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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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, United States, Barbados and Bermuda, is engaged in property and casualty insurance.

NOTE 1 CHANGE IN ACCOUNTING POLICY:

On January 1, 2007, the Company adopted CICA Handbook Section 3855 Financial Instruments - Recognition and Measurement, Section 3865 Hedges and Section 1530 Comprehensive Income.

Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount. Under Section 3855, financial instruments other than insurance contracts must be classified into one of these five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments other than insurance contracts, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held to maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income.

Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with generally accepted accounting principles. A new statement of Comprehensive Income now forms part of the Company's financial statements. Accumulated other comprehensive income is a separate component of shareholders' equity.

Section 3865 describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenues and expenses from derivative financial instruments in the same period as for those related to the hedged item.

Under adoption of these new standards, as at January 1, 2007 the Company classified all its investment securities as available-for-sale ("AFS") except for derivative instruments which are classified as held-for-trading ("HFT"). Available-for-sale and held-for-trading securities are measured at fair value. Accounts receivable, accrued investment income and financed premiums are classified as loans and receivables, which are measured at amortized cost. Bank indebtedness, loans payable, accounts payable and accrued liabilities, senior unsecured debentures and subordinated indebtedness are classified as other financial liabilities, which are measured at amortized cost.

As required, except to classify unrealized foreign currency translations gains/(losses) on net investments in self-sustaining foreign operations under the new caption "accumulated other comprehensive income (loss)", prior periods have not been restated. As a result of these new standards, the following adjustments were made to our balance sheet on January 1, 2007:

Balance sheet category	January 1, 2007 increase
Available-for-sale securities1	$ 26,470
Income taxes2	8,798
Accumulated other comprehensive income (after-tax impact)3	17,672

1 To record these securities at fair value

2 To record income taxes on the components of accumulated other comprehensive income
3 After-tax impact related to net unrealized gains on available-for-sale securities

The components of accumulated other comprehensive income (loss) as at December 31, 2007 and 2006, and other comprehensive income (loss) for the years then ended are as follows:

Accumulated other comprehensive income (loss)	Opening balance December 31, 2006	Transition January 1, 2007	Net change	Ending balance December 31, 2007	Ending balance December 31, 2006
Unrealized gains (losses) on translating financial statement of self-sustaining foreign operation	7,011	-	54,610	61,621	7,011
Unrealized gains, net of income taxes	-	17,672	19,885	37,557	-
Reclassification to net income (loss) of realized gains, net of income taxes	-	-	(13,312)	(13,312)	-
Accumulated other comprehensive income (loss)	7,011	17,672	61,183	85,866	7,011

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

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition, and divestitures are included up to the date of disposal. Assets and liabilities of the acquired companies are included in the financial statements at their fair values at the date of acquisition. The Company holds interests in variable interest entities that are not included in the consolidated financial statements and which are more fully described in Note 16.

The following is a list of our material subsidiaries, all of which are 100% owned, directly or indirectly, (except for qualifying shares of York Fire & Casualty Insurance Company and 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. (Illinois); American Country Insurance Company (Illinois); American Country Financial Services Corp. (Illinois); American Country Underwriting Agency Inc. (Illinois); American Country Professional Services Corp. (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); Auto Body Tech Inc. (Florida); Funding Plus of America (Alabama); 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); York Fire & Casualty Insurance Company (Ontario); Zephyr Insurance Company (Hawaii); and RPC Insurance Agency L.L.C. (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:

Commencing January 1, 2007, all financial instruments previously classified as investments were designated as available-for-sale securities 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, 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 our 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. At December 31, 2007 and 2006, the carrying values of goodwill were $72,106,000 and $69,030,000, respectively.

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. At December 31, 2007 and 2006 intangible assets with definite useful lives, net of accumulated amortization, were $34,615,000 and $19,570,000, respectively.

Intangible assets with indefinite useful lives are not subject to amortization and are tested at least annually for impairment to ensure that fair value is greater than or equal to carrying value. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined. At December 31, 2007 and 2006 the Company had intangible assets with an indefinite life of $10,053,000 and $2,250,000, respectively.

Amortization of intangible assets reported in the Consolidated Statements of Operations for the years ended December 31, 2007, 2006 and 2005 was $4,007,000, $1,030,000 and $795,000, respectively. There were no write-downs of goodwill or intangible assets due to impairment during the years ended December 31, 2007, 2006, and 2005.

(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.

Commencing January 1, 2007, 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 8. 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 EIC 162 relating to stock-based compensation for employees eligible to retire before the vesting date. The additional stock compensation expense relating to eligible employees for fiscal year 2007 and 2006 was $145,000 and $648,000 respectively.

(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.

NOTE 3 FUTURE CHANGE IN ACCOUNTING POLICY AND DISCLOSURE:

In December 2006, the CICA issued three new accounting standards: Accounting Changes, Handbook Section 1535, Capital Disclosures, Handbook Section 3862, Financial Instruments - Disclosures and Handbook Section 3863, Financial Instruments - Presentation. The following summarizes the future accounting changes that will be relevant to the Company’s consolidated financial statements commencing January 1, 2008.

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.

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.

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NOTE 4 SECURITIES: The amortized cost and fair values of investments are summarized below:

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

December 31, 2006

		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Term deposits		$ 379,574	$ 45	$ 491	$ 379,128
Bonds:					
Canadian	- Government	221,458	2,585	294	223,749
	- Corporate	293,849	5,068	689	298,228
U.S.	- Government	70,275	334	1,077	69,532
	- Corporate	1,304,110	3,906	18,873	1,289,143
Other	- Government	40,326	348	724	39,950
	- Corporate	185,268	1,592	2,751	184,109
Sub-total		$ 2,494,860	$ 13,878	$ 24,899	$ 2,483,839
Common shares	- Canadian	182,326	28,927	11,888	199,365
	- U.S.	184,376	23,942	3,490	204,828
		$ 2,861,562	$ 66,747	$ 40,277	$ 2,888,032

The following tables highlight the aggregate unrealized loss position, by security type, of holdings in an unrealized loss position as at December 31, 2007 and 2006. The tables segregate the holdings based on the period of time the securities have been continuously held in an unrealized loss position.

	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	141	91	216	448
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	295	123	223	641
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)

				December 31, 2006
	0-6 months	6-12 months	Over 12 months	Total
Common Shares				
Number of positions	117	7	11	135
Fair Value	$ 95,247	$ 24,447	$ 3,892	$ 123,586
Carrying Value	106,904	27,516	4,544	138,964
Unrealized loss	(11,657)	(3,069)	(652)	(15,378)
Term Deposits and Bonds				
Number of positions	163	41	365	569
Fair value	$ 454,889	$ 255,388	$ 903,409	$ 1,613,686
Carrying Value	456,673	256,391	925,521	1,638,585
Unrealized loss	(1,784)	(1,003)	(22,112)	(24,899)
Total				
Number of positions	280	48	376	704
Fair Value	$ 550,136	$ 279,835	$ 907,301	$ 1,737,272
Carrying Value	563,577	283,907	930,065	1,777,549
Unrealized loss	(13,441)	(4,072)	(22,764)	(40,277)

Fair values of term deposits, bonds and common and preferred shares are considered to approximate quoted market values based on the latest bid prices.

Management has reviewed currently available information regarding those investments whose estimated fair values are less than their carrying amounts and ascertained that the carrying amounts are expected to be recovered. Debt securities whose carrying amounts exceed fair value can be held until maturity when management expects to receive the principal amount. Principally, unrealized losses on debt securities have arisen due to increases in market interest rates rather than deteriorating creditworthiness of the issuers.

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;

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- 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; and
- determining the necessary provision for declines in market value that are considered other than temporary based on the analyses performed.

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.

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

	2007	2006	2005
Investment income:			
Interest on short-term investments	$ 21,437	$ 17,547	$ 9,881
Interest on bonds	108,612	90,826	73,615
Dividends	12,536	12,026	8,939
Premium finance	4,951	5,836	7,059
Other	2,057	2,258	1,447
Gross investment income	149,593	128,493	100,941
Investment expenses	8,137	7622	7906
Net investment income	$ 141,456	$ 120,871	$ 93,035

Net realized gains for the years ended December 31, 2007, 2006, and 2005 were $52,111,000, $28,987,000 and $38,239,000, respectively. Included in net realized gains were adjustments to the carrying values of investments for declines in market value considered other than temporary of $20,410,000, $4,582,000 and $4,806,000 for the years ended December 31, 2007, 2006 and 2005, respectively.
As at December 31, 2007, bonds and term deposits with an estimated fair value of $48,120,000 (2006 - $40,260,000) were on deposit with regulatory authorities.

NOTE 5 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, price risk, liquidity risk and

cash flow risk. Price risk arises from changes in interest rates, foreign currency exchange rates and changes in market conditions whether caused by factors specific to an individual instrument or factors affecting all instruments traded in the market.
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 investment securities and balances receivable from policyholders and reinsurers. The Company has policies to limit and monitor its exposure to individual issuers or related groups (with the exception of U.S. and Canadian government bonds). 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.

Price, liquidity and cash flow risk:
The Company is exposed to:
- Changes in the value of its fixed income securities to the extent that market interest rates change;
- Foreign currency risks with respect to securities, receivables and policies denominated in foreign currencies;
- Changes in the value of equity and fixed income securities as a result of market conditions
- The risk of losses to the extent that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows; and
- The risk that future inflation of policyholder cash flows exceeds returns on long-dated investment securities.

To mitigate these risks, 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.

(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 and are best evidenced by quoted market prices, if they exist. Some of the Company's financial liabilities lack an active trading market. Therefore, these instruments have been valued using present value or other valuation techniques and thus, may not necessarily be indicative of the amounts realizable in an immediate settlement of the instruments. Also, 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.
Refer to Note 4 with respect to fair value disclosure on securities. The fair value of unpaid claims and the fair value of amounts due from reinsurers and other insurers have been omitted because it is not practicable to determine their fair value with sufficient reliability.

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The tables below summarizes the fair valuation of debt liabilities.

As at December 31	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)
	Total Fair Value*	Total Carrying Value	2006 Favourable/ (Unfavourable)
Loans Payable	$ 68,485	$ 66,222	$ (2,263)
Senior unsecured debentures	197,238	191,930	(5,308)
Subordinated indebtedness	90,500	90,500	-

* The fair value is based on quoted market prices where they are available. Otherwise, fair value is estimated based on future cash flows discounted at current interest rates.

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

(c) Interest rate risk:
Duration is a measure used to estimate the extent to which market values change with changes in interest rates. Using this measure, it is estimated that an immediate hypothetical 100 basis point parallel increase in interest rates would decrease the market value of our fixed income securities by $92.3 million (2006 - $76.0 million), representing 3.3% (2006 - 3.1%) of the $2,814.6 million (2006 - $2,483.8 million) fair value fixed income securities portfolio.
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	$ 161,635	$ -	$ -	$ -	$ -	$ 161,635
Securities	714,339	1,242,667	720,464	137,122	441,773	3,256,365
Accrued investment income	33,186	-	-	-	-	33,186
Finance premiums	91,851	-	-	-	-	91,851
Accounts receivable and other assets	365,410	-	-	-	-	365,410
Due from reinsurers and other insurers	(5,999)	181,135	27,676	4,325	-	207,137
Liabilities:						

Bank indebtedness	172,436	-	-	-	-	172,436
Loans payable	-	-	66,222	-	-	66,222
Accounts payable and accrued liabilities	144,940	-	-	-	-	144,940
Unpaid claims	735,534	1,284,106	213,264	34,178	-	2,267,082
Senior unsecured debentures	-	99,680	120,400	-	-	220,080
Subordinated indebtedness	-	-	-	87,354	-	87,354

The coupon rates for the fixed term securities range from 2.5% to 12.0% at December 31, 2007 (2.25% to 11.0% at December 31, 2006). The average effective yield (using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts) is 4.7% (2006 - 4.4%).

(d) Credit risk:

The Company is exposed to credit risk principally through its fixed income securities and balances receivables from reinsurers and policyholders. The company's credit exposure to any one individual policyholder is not material. 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 S&P or Moody's Investor Services, using the higher of these ratings for any security where there is a split rating:

		2007		2006
AAA/Aaa	$ 1,516,064	53.9%	$ 1,341,230	54.0%
AA/Aa2	661,891	23.5	599,719	24.1
A/A2	470,909	16.7	441,553	17.8
BBB/Baa2	96,076	3.4	69,298	2.8
BB/Ba2	8,081	0.3	9,725	0.4
B/B2	12,629	0.4	15,578	0.6
CCC/Caa or lower, or not rated	48,942	1.8	6,736	0.3
Total	$ 2,814,592	100.0%	$ 2,483,839	100.0%

NOTE 6 CAPITAL ASSETS:

	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

	Cost	Accumulated Amortization	2006 Carrying Value
Land	$ 10,439	$ -	$ 10,439

Buildings	77,746	5,319	72,427
Leasehold improvements	13,627	3,276	10,351
Furniture and equipment	11,929	6,756	5,173
Computers and software	31,863	22,890	8,973
Automobiles	2,008	1,222	786
Total	$ 147,612	$ 39,463	$ 108,149

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NOTE 7 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, 2004	56,210,250	1,731,510	$ 13.73	$ 328,544
Stock options:				
Granted in year		552,576	19.70	
Exercised in year	270,203	(270,203)	11.48	2,511
Forfeited in year		(46,368)	17.91	
Stock-based compensation expense				415
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 7(f)	(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 7(g)	(445,100)			(3,404)
Balance as at December 31, 2007	55,515,728	2,772,823	$ 19.03	$ 326,151

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

(a) During the year ended December 31, 2007, options to acquire 76,303 shares (2006 - 209,072; 2005 - 270,203 shares) were exercised at prices from C$4.30 to C$19.70 per share (2006 - C$4.30 to C$19.70 per share; 2005 - C$4.30 to C$19.66 per share).
(b) The weighted average number of shares outstanding for the years ended December 31, 2007, 2006 and 2005 were 55,656,913, 56,233,964 and 56,423,207, respectively. On a diluted basis, the weighted average number of shares outstanding for the years ended December 31, 2007, 2006 and 2005 were 55,944,060, 56,868,785 and 56,962,868, respectively.
(c) During 2007, the Company declared dividends payable in Canadian dollars of C$0.075 per share payable for each quarter. Total dividends declared in 2007 were C$0.30 per common share. Dividends paid to common shareholders during 2007 were C$16,685,633 and C$14,749,872 in 2006.
(d) Options exercised during the year resulted in an increase in share capital from contributed surplus of $202,000 for the year ended December 31, 2007 and $400,000 for the year ended December 31, 2006.

(e) On November 8, 2005 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 7, 2006 the Company repurchased 562,800 of its common shares at an average price of $19.66.

(f) 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 may repurchase up to 2,800,000 of its common shares in total representing approximately 5% of the 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.

(g) 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 may repurchase up to 2,780,000 of its common shares representing less than 5% of the outstanding common shares. For the period of November 13, 2007 to December 31, 2007, the Company had repurchased 123,700 of its common shares at an average price of $16.68. For the year ended December 31, 2007 the company had repurchased a total of 445,100 of its common shares at an average price of $18.20.

NOTE 8 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, 2007, the maximum number of common shares that may be issued under the plan is 4,800,000 (2006 - 4,800,000) common shares. The maximum number of common shares available for issuance to any one person under the stock option plan is 5% of the common shares outstanding at the time of the grant.

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

The intrinsic value of a stock option grant is the difference between the current market price for the Company's common shares and the exercise price of the option. The aggregate intrinsic values for the stock options outstanding at December 31, 2007, 2006 and 2005 were nil, C$14.6 million and C$15.4 million, respectively. The aggregate intrinsic values for stock options exercisable at December 31, 2007, 2006 and 2005 were nil, C$11.9 million and C$9.5 million, respectively.

The following tables summarize information about stock options outstanding as at December 31, 2007, December 31, 2006 and December 31, 2005:

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

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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December 31, 2005

	Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$	19.70	14-Feb-05	14-Feb-10	4.1	542,500	-
C$	15.19	12-Feb-04	12-Feb-09	3.1	424,004	130,337
C$	13.53	10-Feb-03	10-Feb-13	7.1	394,505	248,672
C$	19.66	21-Feb-02	21-Feb-12	6.2	340,000	340,000
C$	7.80	22-Feb-01	22-Feb-11	5.2	146,170	146,170
C$	4.30	24-Feb-00	24-Feb-10	4.2	120,336	120,336
		Total		4.9	1,967,515	985,515

At December 31, 2007, 2006 and 2005 the number of options exercisable were 1,685,006, 1,249,359 and 985,515, respectively, with weighted average prices of C$16.45, C$14.81 and C$13.89, respectively.
The Company determines the fair values of options granted using the Black-Scholes option pricing model. The per share 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 and 2005 were C$6.88 and C$3.58.
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:

	2007	2006	2005
Stock option expense included in employee compensation expense	$ 2,468	$ 2,515	$ 1,883
Net income, as reported	$ (18,526)	$ 123,309	$ 135,008
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	$ (18,526)	$ 123,309	$ 134,940
Basic earnings per share			
As reported	$ (0.33)	$ 2.19	$ 2.39
Pro forma	(0.33)	2.19	2.39
Diluted earnings per share			
As reported	$ (0.33)	$ 2.17	$ 2.37
Pro forma	(0.33)	2.17	2.37

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:

	Dec1 2007	Feb 2007	2006	2005
Risk-free interest rate	3.82%	4.11%	4.02%	3.53%

Dividend yield	2.5%	1.3%	1.02%	0.9%
Volatility of the expected market price of the Company's common shares	28.8%	25.2%	31.4%	22.5%
Expected option life (in years)	3.0	4.0	3.5	3.9

1 Note: Special options granted of 25,000 at December 31 to retired C.E.O.

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, 2007, 2006 and 2005 totalled $885,000, $727,000 and $553,000, respectively.

NOTE 9 PENSION BENEFITS:

The Company maintains a separate defined contribution pension plan 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$19,000, C$18,000 and C$16,500 for 2007, 2006 and 2005 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 to an overall limitation of $15,500 in 2007, $15,000 in 2006 and $14,000 in 2005. 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, 2007, 2006 and 2005 totalled $1,389,000, $1,581,000 and $1,247,000, respectively. All Company obligations to the plans were fully funded as of December 31, 2007.
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 $25,000, $104,000 and $113,000 in 2007, 2006, and 2005 respectively.

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NOTE 10 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.

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

Years ended December 31

		2007		2006		2005
Property claims						
- Canadian operations	C$	1,000	C$	1,000	C$	500
- 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

		2007		2006		2005
Canada						
- Retained loss	C$	5,000	C$	5,000	C$	5,000
- Maximum coverage	C$	120,000	C$	145,000	C$	145,000
United States						
- Retained loss	$	5,000	$	5,000	$	2,000
- Maximum coverage	$	35,000	$	20,000	$	18,000

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 $7,540,000 in net losses subject to a maximum cover of $1,200,000,000.

During 2004, the Company entered into two quota-share contracts. The Company did not renew the quota share reinsurance treaties upon their expiry on April 1, 2005.

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, 2007, 2006 and 2005 were as follows:

		2007		2006		2005
Net premiums earned	$	139,188	$	127,274	$	123,715

Claims incurred	31,007	39,256	90,506
Commissions and premium taxes	29,554	29,018	34,498

The amounts of assumed premiums written were $80,225,000, $86,211,000 and $141,799,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The amounts of assumed premiums earned were $84,221,000, $93,091,000 and $142,831,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

NOTE 11 INCOME TAXES:

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

	2007	2006	2005
Provision for taxes at Canadian statutory marginal income tax rate	$ (7,734)	$ 50,515	$ 55,750
Valuation allowance	20,202	-	-
Non-taxable investment income	(799)	(398)	(1,812)
Foreign operations subject to different tax rates	(16,860)	(33,892)	(34,218)
Change in tax rates and other	2,306	320	(381)
Provision for income taxes	$ (2,885)	$ 16,545	$ 19,339

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

	2007	2006
Future income tax assets:		
Losses carried forward	$ 105,222	$ 33,398
Unpaid claims and unearned premiums	30,123	32,090
Securities	2,032	8,526
Share issue expenses	158	430
Profit commission accruals	2,131	5,510
Other	9,432	39,631
Valuation allowance	(20,700)	(498)
Future income tax assets	128,398	119,087
Future income tax liabilities:		
Deferred policy acquisition costs	(5,104)	(39,313)
Securities	(3,958)	(525)
Guaranteed payments	(4,931)	(2,572)
Other	(339)	(1,465)
Future income tax liabilities	(14,332)	(43,875)
Net future income tax assets	$ 114,066	$ 75,212

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(c) Amounts and expiration dates of the operating loss carryforwards are 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	4,405
	2003	2023	308
	2004	2024	207
	2005	2025	282
	2006	2026	75,729
	2007	2027	211,273

(d) The Company established valuation allowances of $20,700,000 and $498,000 for its gross future tax assets at December 31, 2007 and 2006, 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, with the exception of a portion of its net operating losses. The valuation allowances are 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 12 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 claim 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, 2007, 2006 and 2005 were as follows:

	2007	2006	2005
Unpaid claims - beginning of year - net	$ 1,762,932	$ 1,662,551	$ 1,463,280
Net unpaid claims of subsidiaries acquired	65,332	-	-
Provision for claims occurring:			
In the current year	1,279,668	1,193,288	1,217,952
In prior years	180,395	64,329	24,233
Claims paid during the year relating to:			
The current year	(520,557)	(409,236)	(424,997)
The prior years	(801,887)	(745,286)	(674,373)
ClClaims transferred on expiry of quota share agreement	-	-	33,788
Currency translation adjustment	123,528	(2,714)	22,668
Unpaid claims - end of year - net	2,089,411	1,762,932	1,662,551
RReinsurers' and other insurers' share of unpaid claims	177,671	176,431	181660
Unpaid claims - end of year	$ 2,267,082	$ 1,939,363	$ 1,844,211

The results for the years ended December 31, 2007, 2006 and 2005 were adversely affected by the evaluation of unpaid claims related to prior years. In 2005, unfavourable development on unpaid claims came primarily from a terminated trucking program and Alberta non-standard automobile claims and in 2006 and 2007 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 favourable reserve development of $32.0 million in the 2007 compared to $11.1 million in 2006. Non-standard automobile contributed $14.3 million of favourable development in 2007 compared to $5.4 million and unfavourable development of $8.6 million in 2006 and 2005, respectively. Ontario non-standard automobile business contributed $10.1 million of the favourable development in 2007 and Alberta contributed $3.3 million. Standard automobile business contributed $8.8 million. Stable market conditions in the province of Ontario and improved reserving methodology has enabled the Canadian operations to show favourable development in 2007.

U.S. Operations

The U.S. operations reported unfavourable reserve development of $212.4 million in 2007 compared to $75.4 million in 2006. 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 the previous claims reserves were inadequate resulting in unfavourable development of the prior years' claims reserves. Trucking business contributed $149.7 million of the prior years' claims development in 2007, compared to $59.4 million in 2006 and $29.5 million in 2005. Property and liability business contributed $58.3 million of the prior years' claims development in 2007, compared to $13.5 million in 2006 and $17.4 million in 2005. Allocated loss adjustment expenses on contractors' claims in the property and liability segment contributed $53.6 million in prior years' claims development in 2007 and $19.6 million in 2006 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 point estimates recommended by their independent appointed actuary, those gross reserve levels will be increased to levels that are no less than the point estimate 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, 2007	Low	High	Point 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
As of December 31, 2006	Low	High	Point Estimate	Carried
U.S. Operations	$ 990,991	$ 1,274,850	$ 1,132,431	$ 1,138,407
Canadian Operations	684,189	915,267	799,944	800,956
Total	$ 1,675,180	$ 2,190,117	$ 1,932,375	$ 1,939,363

(d) The fair value of unpaid claims and adjustment expenses, gross and recoverable from reinsurers, has been omitted because it is not practicable to determine fair value with sufficient reliability.

NOTE 13 ACQUISITIONS:

(a) Zephyr:
On October 31, 2005, the Company acquired 100% of the voting shares of HI Holdings Inc. for an estimated $25,000,000. During 2006 the final purchase price was agreed with the sellers at $24,629,000, and goodwill of $4,494,000 was recorded with respect to this acquisition that included Zephyr Insurance Company Inc., a wholly-owned subsidiary of HI Holdings, whose primary business is residential hurricane insurance. The earnings of HI Holdings have been included in the statement of operations from November 1, 2005. HI Holdings, at the time of acquisition had total assets of approximately $71,113,000 (excluding goodwill) consisting primarily of marketable securities and total liabilities of approximately $51,541,000.

(b) 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. 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.

(c) 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 has recognized goodwill of $970,000 and intangible assets of $10,669,000 in 2007 related to this acquisition. The final goodwill balance will be determined upon further evaluation. 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.

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

Cash	$	30,526
Investments		87,629
Accounts receivable		34,755
Other tangible assets		11,793
Other assets		
Intangible asset - state insurance licenses		7,803
Intangible asset - agent relationships		1,765
Intangible asset - technology based		1,101
Goodwill		970
Total Assets		176,342
Insurance liabilities		120,956
Accounts payable		1,488
Other liabilities		2,786
Total liabilities		125,230
Purchase price	$	51,112

NOTE 14 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.

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

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

	Canada	United States	Corporate and other	Total
Gross premiums written	$ 570,043	$ 1,392,697	$ -	$ 1,962,740
Net premiums earned	539,637	1,302,481	-	1,842,118
Investment income (loss)	58,606	84,230	(1,380)	141,456
Net realized gains (losses)	26,106	26,014	(9)	52,111
Interest expense	-	30,262	8,605	38,867
Amortization of capital assets	1,961	5,598	4,586	12,145
Amortization of intangible assets	-	4,007	-	4,007
Net income tax expense (recovery)	19,390	(36,443)	14,168	(2,885)
Net income (loss)	90,887	(86,889)	(22,524)	(18,526)
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	$ 590,766	$ 1,341,984	$ -	$ 1,932,750
Net premiums earned	562,444	1,204,053	-	1,766,497
Investment income (loss)	53,026	68,448	(603)	120,871
Net realized gains	16,244	12,743	-	28,987
Interest expense	-	23,086	7,161	30,247
Amortization of capital assets	1,289	3,332	1,625	6,246
Amortization of intangible assets	-	1,030	-	1,030
Net income tax expense (recovery)	22,595	(15,410)	9,360	16,545
Net income (loss)	69,026	62,721	(8,438)	123,309
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

The segmented information for December 31, 2005 is summarized below:

	Canada	United States	Corporate and other	Total
Gross premiums written	$ 609,934	$ 1,284,726	$ -	$ 1,894,660
Net premiums earned	582,491	1,209,452	-	1,791,943
Investment income (loss)	40,595	54,129	(1,689)	93,035
Net realized gains (losses)	23,864	14,406	(31)	38,239
Interest expense	-	19,329	6,592	25,921
Amortization of capital assets	1,007	4,113	1,058	6,178

Amortization of intangible assets	-	795	-	795
Net income tax expense (recovery)	22,389	(5,805)	2,755	19,339
Net income (loss)	65,579	81,553	(12,124)	135,008
Capital assets	$ 21,967	$ 45,158	$ 4,483	$ 71,608
Goodwill and intangible assets	7,903	63,227	-	71,130
Total assets	1,392,469	2,374,081	28,644	3,795,194

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

	2007	2006	2005
Business Line			
Personal Lines:			
Non-standard Auto	31%	26%	29%
Standard Auto	5%	6%	7%
Motorcycle	4%	3%	3%
Property (including Liability)	6%	6%	3%
Other Specialty Lines	2%	2%	2%
Total Personal Lines	48%	43%	44%
Commercial Lines:			
Trucking	21%	33%	31%
Commercial Auto	17%	14%	12%
Property (including Liability)	10%	7%	10%
Other Specialty Lines	4%	3%	3%
Total Commercial Lines	52%	57%	56%
Total Gross Premiums Written	100%	100%	100%

	2007	2006	2005
Geographical Area			
United States:			
California	14%	14%	14%
Florida	10%	9%	10%
Illinois	8%	10%	11%
Texas	5%	6%	6%
New Jersey	2%	3%	3%
New York	7%	4%	1%
Hawaii	4%	3%	1%
Other	21%	20%	22%
Total United States	71%	69%	68%
Canada:			
Ontario	19%	19%	20%
Alberta	2%	4%	5%
Québec	6%	6%	5%
Other	2%	2%	2%
Total Canada	29%	31%	32%
Total Gross Premiums Written	100%	100%	100%

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NOTE 15 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. The amounts outstanding under this facility as at December 31, 2007 and 2006 were $101,369,000 and $51,607,000 with an effective interest rate of 5.9% and 5.7% respectively.
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. The amounts outstanding under this facility as of December 31, 2007 were C$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 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 paid during the year was $9,375,000, $9,375,000 for 2006 and $9,375,000 for 2005 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 senior unsecured debentures at 6% due on July 11, 2012. These debentures bear interest at a fixed rate of 6% per annum payable semi-annually from the date of issuance until July 11, 2012. Interest payments are to be made on January 10 and July 10 of each year, commencing January 10, 2008 with an effective interest rate of 6.3%. The net proceeds to the Company amounted to C$99,188,000. Kingsway 2007 General Partnership may redeem the debentures in whole at any time and in part from time to time, at the Issuer's option. The debentures will be 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 $8,896,000, $8,479,000 for 2006 and $6,702,000 for 2005 with an effective weighted average interest rate of 9.85% for 2007.

(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 was $4,881,000 for both 2007 and 2006 with an effective interest rate of 7.37% for 2007.

(e) Contractual obligations:

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

	2007	2006
Bank indebtedness	$ 172,436	$ 52,149
Construction contracts	-	9,595
Senior unsecured debentures	220,080	191,930
Subordinated indebtedness	87,354	90,550
Loan payable	66,222	66,222
Total	$ 546,092	$ 410,446

NOTE 16 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 of 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 15(d), the effect of this transaction is to show additional debt on the Company’s financial statements and an off-setting equity investment of C$8.3 million in the non-consolidated affiliated entity.

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

NOTE 17 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.

(b) Statutory Requirements:
Statutory policyholders' capital and surplus of the Company's insurance subsidiaries was $1,168.8 million and $1,070.7 million at December 31, 2007 and 2006, respectively.
The Company's subsidiaries are subject to certain requirements and restrictions under applicable state and provincial insurance legislation including minimum asset requirements and dividend restrictions. At December 31, 2007, under the various insurance regulatory restrictions, the Company's insurance and reinsurance subsidiaries have an aggregate dividend capacity of $530.2 million (2006 - $515.9 million).

(c) Letters of Credit:
On October 4, 2002 the Company entered into an annually renewable syndicated $350 million letter of credit facility. 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, 2007 and 2006 the letter of credit facility utilization was $270.9 million and $272.3 million, respectively.
Also, from time to time, the Company pledges securities to third parties to collateralize liabilities incurred under its policies of insurance. At December 31, 2007 and 2006, the amount of pledged securities was $38.6 million and $25.8 million, respectively.

(d) 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.

(e) Guarantee:
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 July 14, 2005 in conjunction with the Kingsway Linked Return of Capital Trust transaction described in Note 15 (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.

(f) Future Minimum Lease Payments:

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

2008	$	3,886
2009		2,068

2010	1,737
2011	1,596
2012	1,368
Thereafter	3,096

NOTE 18 SECURITIZATION TRANSACTION:

During 2006, one of the Company's U.S. subsidiaries entered into a five year revolving securitization agreement to transfer its premium finance receivables to a third party Trust. The premium finance receivables are generally for a six month term corresponding to the underlying insurance policy issued by the U.S. subsidiary. The Company sold finance premium receivables of $16.0 million to the Trust, recorded an associated retained interest in the discounted cash flows from the cash reserve deposit maintained with the Trust and established a liability for future servicing costs. The effect of this off-balance sheet arrangement is to remove the related premium finance receivable asset from the balance sheet.
During 2007 this securitization agreement was terminated. Upon termination, the Company reimbursed $3.7 million advanced by the Trust, net of the cash reserve deposit maintained with the Trust, reversed its liability for future servicing costs and expensed certain deferred costs associated with the set up of the facility. The effect of terminating this off-balance sheet arrangement is to reinstitute the related premium finance receivable asset to the balance sheet.

NOTE 19 RECONCILIATION OF CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES:

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. The significant differences between Canadian GAAP and U.S. GAAP, which affect the Company's consolidated financial statements, are described below:
The following table reconciles the consolidated net income and other comprehensive income as reported under Canadian GAAP with net income and other comprehensive income in accordance with U.S. GAAP:

	2007	2006	2005
Net income based on Canadian GAAP	$ (18,526)	$ 123,309	$ 135,008
Impact on net income of U.S. GAAP adjustments, net of tax:	-	-	-
Net income based on U.S. GAAP*	$ (18,526)	$ 123,309	$ 135,008

	2007	2006	2005
Comprehensive income based on Canadian GAAP	$ 42,657	$ 120,362	$ 143,246
Change in unrealized gain on securities classified as available-for-sale (a)	-	8,271	(43,131)
Less: related future income taxes	-	(1,194)	(6,165)
Other comprehensive income adjustments	-	9,465	(36,966)
Total comprehensive income based on U.S. GAAP	$ 42,657	$ 129,827	$ 106,280
*Basic earnings per share based on U.S. GAAP net income	$ (0.33)	$ 2.19	$ 2.39
*Diluted earnings per share based on U.S. GAAP net income	$ (0.33)	$ 2.17	$ 2.37

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

	2007	2006
Shareholders' equity based on Canadian GAAP	$ 940,801	$ 900,962
Other comprehensive income	-	16,080

Cumulative net income impact:		
Other	(821)	(821)
Shareholders’ equity based on U.S. GAAP	$ 939,980	$ 916,221

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Our 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 $85,866,000 and $23,091,000 as at December 31, 2007 and 2006, respectively.

(a) Securities:

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

b) Income taxes:

In June 2006, the U.S. Financial Accounting Standards Board (FASB) issued FASB interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure.

The Company adopted the provisions of FIN 48 on January 1, 2007. As of January 1, 2007, the Company had no unrecognized tax benefits. The Company analyzed their tax positions in accordance with the provisions of FIN 48 and has determined that there are no uncertain tax positions. As a result, no adjustment to January 1, 2007 stockholders' equity was required. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax benefits.

c) Future accounting pronouncements:

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements. The standard establishes a framework for measuring fair value and expands disclosures surrounding fair value measurement. The requirements of this standard will be effective for the Company beginning January 1, 2008.

In February 2007, the FASB issued Statement No. 159, Fair Value Option for Financial Assets and Liabilities. This standard allows an entity the option to measure certain financial assets and liabilities at fair value. Changes in fair value are recognized in earnings. The requirements of this standard will be effective for the Company beginning January 1, 2008.

NOTE 20 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 the Company ("KFSI") and KAI, another wholly-owned subsidiary. 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, 2007 and 2006 and for the three years ended December 31, 2007, 2006 and 2005, 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, 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	$ -	$ -	$ -	$ 1,842,118	$ -	$ 1,842,118
Investment related income	(1,390)	4,860	6,199	190,097	(6,199)	193,567
Management fees	83,553	13,512	-	-	(97,065)	-
	82,163	18,372	6,199	2,032,215	(103,264)	2,035,685
Expenses:						
Claims incurred	-	-	-	1,233,000	203,340	1,436,340
Commissions and premium taxes	449	-	-	334,351	-	334,800
Other expenses	81,466	21,409	93	450,725	(306,604)	247,089
Interest expense	8,605	26,540	2,994	728	-	38,867
	90,520	47,949	3,087	2,018,804	(103,264)	2,057,096
Income before income taxes	(8,357)	(29,577)	3,112	13,411	-	(21,411)
Income taxes	14,168	10,398	1,058	(28,509)	-	(2,885)
Equity in undistributed net income of subsidiaries	3,999	(108,273)	-	-	104,274	-
Net income	$ (18,526)	$ (148,248)	$ 2,054	$ 41,920	$ 104,274	$ (18,526)

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

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	$ -	$ -	$ 1,766,497	$ -	$ 1,766,497
Investment related income	(603)	3,746	146,715	-	149,858
Management fees	70,439	13,464	-	(83,903)	-
	69,836	17,210	1,913,212	(83,903)	1,916,355
Expenses:					
Claims incurred	-	-	1,255,770	(21,245)	1,234,525
Commissions and premium taxes	(391)	-	328,834	-	328,443
Other expenses	62,143	23,338	160,463	(62,658)	183,286
Interest expense	7,161	22,870	216	-	30,247
	68,913	46,208	1,745,283	(83,903)	1,776,501
Income before income taxes	923	(28,998)	167,929	-	139,854
Income taxes	9,360	(9,854)	17,039	-	16,545
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 Statement of Operations
For the year ended December 31, 2005

	KFSI (the "Guarantor")	KAI (the "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Revenue:					
Net premiums earned	$ -	$ -	$ 1,791,943	$ -	$ 1,791,943
Investment related income	(1,720)	4,400	128,594	-	131,274
Management fees	56,945	8,988	-	(65,933)	-
	55,225	13,388	1,920,537	(65,933)	1,923,217
Expenses:					
Claims incurred	-	-	1,241,202	(16,696)	1,224,506
Commissions and premium taxes	-	-	361,875	-	361,875
Other expenses	52,716	13,511	139,578	(49,237)	156,568
Interest expense	6,591	18,671	659	-	25,921
	59,307	32,182	1,743,314	(65,933)	1,768,870
Income before income taxes	(4,082)	(18,794)	177,223	-	154,347

Income taxes	2,755	(6,743)	23,327	-	19,339
Equity in undistributed net income of subsidiaries	141,845	(319)	-	(141,526)	-
Net income	$ 135,008	$ (12,370)	$ 153,896	$ (141,526)	$ 135,008

Condensed Consolidating
Balance Sheets
As at December 31, 2007

	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	$ 964,286	$ 682,266	$ -	$ (150,463)	$ (1,496,089)	-
Cash	13,716	6,960	566	140,393	-	161,635
Investments	-	-	-	3,348,216	-	3,348,216
Goodwill and other intangible assets	-	-	-	116,774	-	116,774
Other assets	34,042	16,302	113,217	3,181,277	(2,314,058)	1,030,780
	$ 1,012,044	$ 705,528	$ 113,783	$ 6,636,197	$ (3,810,147)	$ 4,657,405
Liabilities and Shareholders' Equity						
Liabilities:						
Bank indebtedness	$ 42,369	$ 170,175	$ -	$ 130,068	$ (103,954)	$ 238,658
Other liabilities	7,797	25,184	6,607	339,938	(234,586)	144,940
Unearned premiums	-	-	-	1,220,813	(462,323)	758,490
Unpaid claims	-	-	-	3,810,139	(1,543,057)	2,267,082
Senior unsecured debentures	21,077	125,000	94,429	(20,426)	-	220,080
Subordinated indebtedness	-	90,500	-	-	(3,146)	87,354
	71,243	410,859	101,036	5,480,532	(2,347,066)	3,716,604
Shareholders' equity:						
Share capital	326,151	342,450	10,667	1,773,287	(2,126,404)	326,151
Contributed surplus	7,619	-	-	-	-	7,619
Currency translation adjustment	521,165	(47,781)	2,053	(713,618)	759,346	521,165
Retained earnings	85,866	-	27	95,996	(96,023)	85,866
	940,801	294,669	12,747	1,155,665	(1,463,081)	940,801
	$ 1,012,044	$ 705,528	$ 113,783	$ 6,636,197	$ (3,810,147)	$ 4,657,405

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

Condensed Consolidating Balance Sheets
As at December 31, 2006

	KFSI (the "Guarantor")	KAI (the "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Assets					
Investments in subsidiaries	$ 985,924	$ 400,807	$ 118,485	$ (1,505,216)	$ -
Cash	3,475	3,204	123,027	-	129,706
Investments	99	-	2,928,991	-	2,929,090
Goodwill and other intangible assets	-	-	82,235	8,615	90,850
Other assets	23,756	51,027	2,478,852	(1,654,943)	898,692
	$ 1,013,254	$ 455,038	$ 5,731,590	$ (3,151,544)	$ 4,048,338
Liabilities and Shareholders' Equity					
Liabilities:					
Bank indebtedness	$ 32,609	$ 66,222	$ 19,540	$	$ 118,371
Other liabilities	12,753	22,168	89,312	527	124,760
Unearned premiums	-	-	1,115,314	(432,862)	682,452
Unpaid claims	-	-	3,132,423	(1,193,060)	1,939,363
Senior unsecured debentures	66,930	125,000	-	-	191,930
Subordinated indebtedness	-	90,500	-	-	90,500
	112,292	303,890	4,356,589	(1,625,395)	3,147,376
Shareholders' equity:					
Share capital	328,473	192,391	1,174,609	(1,367,000)	328,473
Contributed surplus	5,352	-	-	-	5,352
Currency translation adjustment	7,011	-	41,935	(41,935)	7,011
Retained earnings	560,126	(41,243)	158,457	(117,214)	560,126
	900,962	151,148	1,375,001	(1,526,149)	900,962
	$ 1,013,254	$ 455,038	$ 5,731,590	$ (3,151,544)	$ 4,048,338

Condensed Consolidating Statement of Cash Flows
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
Cash provided by (used in):						
Operating activities:						
Net income	$ (18,526)	$ (148,248)	$ 2,053	$ 66,841	$ 79,354	$ (18,526)
Adjustments to reconcile net income to net cash						

used by operating activities:						
Equity in undistributed earnings in subsidiaries	(3,999)	108,273	-	-	(104,274)	-
Other	(44,365)	38,807	(106,583)	197,753	-	85,612
	(66,890)	(1,168)	(104,530)	264,594	(24,920)	67,086
Financing Activities:						
Increase in share capital, net	1,082	150,059	10,667	-	(160,726)	1,082
Repurchase of common shares for cancellation	(8,129)	-	-	-	-	(8,129)
Common share dividend	(15,710)	-	-	-	-	(15,710)
Increase/(decrease) in bank indebtedness	-	103,953	-	-	(103,953)	-
Increase in senior unsecured indebtedness	-	-	94,429	111,776	(94,429)	111,776
Increase in subordinated indebtedness	-	-	-	17,274	-	17,274
	(22,757)	254,012	105,096	129,050	(359,108)	106,293
Investing Activities:						
Purchase of investments	(19,922)	-	-	(4,115,535)	-	(4,135,457)
Proceeds from sale of investments	20,021	-	-	4,054,146	-	4,074,167
Acquisitions	109,179	(51,113)	-	6,392	(109,179)	(44,721)
Other	(9,390)	(197,975)	-	(321,281)	493,207	(35,439)
	99,888	(249,088)	-	(376,278)	384,028	(141,450)
Increase (decrease) in cash during the year	10,241	3,756	566	17,366	-	31,929
Cash, beginning of year	3,475	3,204	-	123,027	-	129,706
Cash, end of year	$ 13,716	$ 6,960	$ 566	$ 140,393	$ -	$ 161,635

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

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

	KFSI (the "Guarantor")	KAI (the "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Cash provided by (used in):					
Operating activities:					
Net income	$ 123,309	$ (32,687)	$ 150,891	$ (118,204)	$ 123,309
Adjustments to reconcile net income to net cash used by operating activities:					
Equity in undistributed earnings in subsidiaries	(131,747)	13,543	-	118,204	-
Other	6,593	(4,503)	41,829	-	43,919
	(1,845)	(23,647)	192,720	-	167,228
Financing Activities:					
Increase in share capital, net	3,005	35,000	-	(35,000)	3,005
Repurchase of common shares for cancellation	(16,246)	-	-	-	(16,246)
Common share dividend	(12,988)	-	-	-	(12,988)
Increase/(decrease) in bank indebtedness	21,891	-	18,954	-	40,845
Increase in senior unsecured indebtedness	-	-	-	-	-
Increase in subordinated indebtedness	-	-	-	-	-
	(4,338)	35,000	18,954	(35,000)	14,616
Investing Activities:					
Purchase of investments	(307)	-	(3,279,678)	-	(3,279,985)
Proceeds from sale of investments	406	2,983	3,160,826	-	3,164,215
Acquisitions	7,023	(943)	(21,472)	(7,023)	(22,415)
Other	(295)	(19,786)	(46,929)	42,023	(24,987)
	6,827	(17,746)	(187,253)	35,000	(163,172)
Increase (decrease) in cash during the year	644	(6,393)	24,421	-	18,672
Cash, beginning of year	2,831	9,597	98,606	-	111,034
Cash, end of year	$ 3,475	$ 3,204	$ 123,027	$ -	$ 129,706

Condensed Consolidating Statement of Cash Flows

For the year ended December 31, 2005

	KFSI (the "Guarantor")	KAI (the "Issuer")	Other subsidiaries (the "Non-Guarantor subsidiaries")	Consolidation adjustments	Total
Cash provided by (used in):					
Operating activities:					
Net income	$ 135,008	$ (12,370)	$ 153,896	$ (141,526)	$ 135,008
Adjustments to reconcile net income to net cash used by operating activities:					
Equity in undistributed earnings in subsidiaries	(141,845)	319	-	141,526	-
Other	11,390	(1,506)	128,855	-	138,739
	4,553	(13,557)	282,751	-	273,747
Financing Activities:					
Increase in share capital, net	2,926	(20,283)	-	20,283	2,926
Common share dividend	(9,426)	-	-	-	(9,426)
Increase/(decrease) in bank indebtedness	(28,532)	66,222	(20,312)	-	17,378
Increase in senior unsecured indebtedness	-	-	-	-	-
Increase in subordinated indebtedness	-	-	-	-	-
	(35,032)	45,939	(20,312)	20,283	10,878
Investing Activities:					
Purchase of investments	(9,053)	(24,436)	(2,556,529)	-	(2,590,018)
Proceeds from sale of investments	9,177	21,682	2,325,722	-	2,356,581
Acquisitions	32,058	(23,934)	12,042	(32,058)	(11,892)
Other	(2,807)	2,032	(26,365)	11,775	(15,365)
	29,375	(24,656)	(245,130)	(20,283)	(260,694)
Increase (decrease) in cash during the year	(1,104)	7,726	17,309	-	23,931
Cash, beginning of year	3,935	1,871	81,297	-	87,103
Cash, end of year	$ 2,831	$ 9,597	$ 98,606	$ -	$ 111,034

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Document No. 3

Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

SHARPENING OUR FOCUS FOR CONSISTENT AND IMPROVING RESULTS

CONTENTS

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this annual report. The commentary is current as of March 14, 2008. Our financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). Note 19 of the consolidated financial statements provides a reconciliation of Canadian and United States GAAP. Additional information relating to Kingsway Financial Services Inc. ("Kingsway") is available on SEDAR at www.sedar.com and on the EDGAR section of the U.S. Securities and Exchange Commission's ("SEC's") website at www.sec.gov, each of which can also be accessed from our website www.kingsway-financial.com. This annual report, including the following discussion, contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward looking statements as a result of several factors, including those set forth under the section entitled "Risk Factors" beginning on page 47 and elsewhere in the annual report.

From time to time, we make written and oral forward-looking statements, in this annual report, in other filings with Canadian regulators or the SEC and in other communications. Forward-looking statements include, among others, statements regarding the Company's objectives and the strategies to achieve them. 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. Some of the factors that could cause such differences are discussed under the section of this annual report entitled "Risk Factors" and in other regulatory filings made in Canada and with the SEC. 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, and undue reliance should not be placed on the Company's forward-looking statements. The Company does not undertake to update any forward-looking statements, written or oral, that may be made from time to time on its behalf.

All of the dollar amounts in this annual report 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. As presented in this annual report, our Canadian and U.S. segment information includes the results of our Bermuda and Barbados reinsurance subsidiaries, respectively.

NON-GAAP MEASURES

The Company uses both GAAP and certain non-GAAP measures to assess performance. Securities regulators require that companies caution readers about non-GAAP measures that do not have a standardized meaning under GAAP and are unlikely to be comparable to similar measures used by other companies. Kingsway, like many insurance organizations, analyzes performance based on underwriting ratios such as combined, expense and loss ratios. The claims ratio is derived by dividing the amount of net claims incurred by net premiums earned. The expense ratio is derived by dividing the sum of commissions and premium taxes and general and administrative expenses by net premiums earned. The combined ratio is the sum of the claims ratio and the expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates an underwriting loss. We believe that consistently delivering an underwriting profit is a key measure of performance of the underwriting business of a property and casualty insurance company. The Company includes all corporate overhead in the calculation of its expense ratio and combined ratio, a policy that may vary from other insurance companies.
The Company also uses securities portfolio per share information that is calculated based on the fair value of the securities portfolio divided by the number of issued and outstanding common shares.
The Company uses operating earnings information that is calculated as net income excluding after-tax net realized gains and losses on securities. A reconciliation of net income to operating earnings is presented in Table 1. We believe operating earnings excluding after-tax realized gains is a better reflection, compared with net income, of our on-going earnings capacity as the timing and quantity of realized gains can vary widely from year to year but is not indicative of performance.

REPORTING CURRENCY

As the majority of the Company's operations are in the United States or are conducted in U.S. dollars, effective December 31, 2005 the Company has prepared its financial statements and its Management's Discussion and Analysis in U.S. dollars in order to provide more meaningful information to its users. The Company's functional currencies, however, will remain Canadian dollars for Canadian and head office operations and U.S. dollars for U.S. operations. To effect this conversion, figures contained in this report have been translated into U.S. dollars using the current rate method, pursuant to which the consolidated statements of earnings and cash flows have been translated using the average rate of exchange for the relevant year, all assets and liabilities have been translated using the relevant year end rate of exchange and share capital has been translated using the rates of exchange in effect as of the dates of various capital transactions. Foreign exchange differences arising from the translations as described above are included in shareholders' equity under the caption "Accumulated Other Comprehensive Income". All relevant financial information has been restated to reflect the Company's results as if they had been historically reported in U.S. dollars.

TABLE 1 Reconciliation of net income to net operating income
(In thousands of dollars)

	2007	2006	2005
Net income (loss), as reported	$ (18,526)	$ 123,309	$ 135,008
Net realized gains before taxes, as reported	52,111	28,987	38,239
Ta x effect on net realized gains	11,320	5,614	9,589
Net realized gains after tax	40,791	23,373	28,650
Net operating income (loss)	$ (59,317)	$ 99,936	$ 106,358

OVERVIEW

OUR COMPANY

Kingsway is a specialty provider of personal and commercial lines of property and casualty insurance in the United States and Canada. Our primary businesses are the insuring of automobile risks for drivers who do not meet the criteria for coverage by standard automobile insurers (also referred to as 'non-standard' automobile insurance) and trucking insurance. We are one of the largest non-standard automobile and truck insurers in North America based on A.M. Best data that we have compiled and we are the largest writer of motorcycle insurance in Canada.

Non-standard automobile insurance covers 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. Such drivers typically represent higher than normal risks and usually pay higher insurance rates for comparable coverage. We are the leading provider of non-standard automobile insurance in Canada and have a prominent position in several U.S. markets including Illinois and Florida.

We provide trucking coverage for liability, accident benefits, physical damage, cargo and comprehensive general liability under a package program throughout Canada and
the United States. We also provide standard automobile insurance as well as insurance for commercial and public vehicles, including taxis.

In addition, we provide motorcycle insurance, specialized commercial and personal property coverages, residential wind insurance coverage in Hawaii, construction defect claims in California and other specialty coverages, such as customs, bail and surety bonds.

For the year ended December 31, 2007, we derived 31% of our gross premiums written from non-standard automobile insurance, 21% from trucking insurance, 17% from commercial automobile insurance, 16% from commercial and personal property coverages, 5% from standard automobile insurance, 4% from motorcycle insurance and 6% from other specialty lines. During the year ended December 31, 2007, we generated 71% of our gross premiums written from the United States and 29% from Canada.

Kingsway Financial Services Inc. is the holding company for all of our subsidiaries and Kingsway America is the holding company for all of our U.S. operating subsidiaries. We operate our business through our insurance subsidiaries which include Kingsway General Insurance Company, York Fire & Casualty Insurance Company, and Jevco Insurance Company in Canada and Universal Casualty Company, Southern United Fire Insurance Company, American Service Insurance Company, Inc., Lincoln General Insurance Company, U.S. Security Insurance Company, American Country Insurance Company, Zephyr Insurance Company, Inc., Mendota Insurance Company and Mendakota Insurance Company. We also have wholly owned reinsurance subsidiaries domiciled in Bermuda and Barbados and two wholly owned insurance agencies in the U.S., Avalon Risk Management, Inc. and the Robert Plan Corporation Insurance Agency, LLC.

In early 2007, we acquired Mendota Insurance Company (“Mendota”) and its subsidiary companies. Mendota is a dedicated non-standard insurance provider licensed in 43 states and currently writes business in 20 states through a network of approximately 6,000 independent agency locations.

During the year ended December 31, 2007, shareholders’ equity increased 4% to $940.8 million, and as of December 31, 2007, we had total assets of $4.66 billion. Our book value per share increased by 5% to $16.95 in 2007 and has increased at a compound annual growth rate of 16% for the five year period to the end of 2007. Despite a net loss in 2007, our return on equity has averaged 12.1% for the five years from 2003 to 2007.

OUR INDUSTRY

The property and casualty insurance industry in the U.S. and Canada is highly competitive and fragmented. We generally seek, therefore, to identify and operate in specialty markets that present opportunities for us to compete effectively due to the narrow scope or limited size of the market or the specialty nature of the coverage or risk. These specialty markets may be defined by geographic area, type of insurance or other factors. We focus on specialty lines of automobile, property and casualty insurance where we believe competition is more limited. We emphasize underwriting profit and will not knowingly underwrite risks at rates that we believe are unprofitable in order to increase our premium volume. We believe that by executing this strategy we will be able to deliver returns that will exceed the average in our industry over a long period of time.

Since 2004, insurance markets have experienced increased competition due to improved profitability and greater capitalization, forcing premium rates down. In 2007, the insurance markets in which we operate continued to exhibit the ‘soft’ market characteristics of excessive capital contributing to declining premium rates. Compared to previous soft cycles, however, legislation, improved management information and low interest rates appear to have reduced some of the irrational pricing. The non-standard auto insurance market is populated by smaller providers who typically have less sophisticated management systems and tend to respond less rationally following periods of superior profits. Once the extent of the irrational pricing becomes clear, the return to a hard market is usually quick as capital retreats.

The trucking insurance market in which we operate involves the underwriting of smaller owner/operator fleets. Although this market has seen some rate reductions, it is less competitive than the insuring of larger fleets allowing for relatively stable pricing.

CORPORATE STRATEGY

Our strategy is to specialize in areas of insurance where we have developed expertise including non-standard automobile, trucking, motorcycle, taxis and other specialty niche markets. We then bring this expertise, underwriting discipline and knowledge to a broad range of geographic markets so that our risks are well diversified. Our strategy is to build long-term shareholder value and is characterized by the following principles:

- Distinctive underwriting capabilities in target specialty markets
  We seek to identify market segments where we believe competition is more limited, presenting the potential for above average underwriting results. We operate through a network of regionally based operating subsidiaries. Our decentralized operating structure allows us to target specialized markets and products based on our underwriting expertise and knowledge of local market conditions.
  We rely on our detailed understanding of our regional markets to take advantage of favourable conditions or trends. We look for opportunities to expand our specialty focus into selected regional markets and to increase the distribution of our core products in existing territories. We may also look for opportunities to acquire books of business or other companies which are in line with our specialty focus.

- An extensive network of independent agents and program managers focused on specialty markets
  We are committed to our distribution network of approximately 9,000 independent agents, and approximately 30 program managers in the U.S. and approximately 3,000 independent brokers in Canada.
  We continually strive to provide the highest level of service to agents, program managers and brokers and to build relationships at the local level in the markets in which we operate. We communicate with our network through a variety of channels and we look for opportunities to increase efficiency and further reduce operating costs, including through the use of technology and automation. We also look for opportunities to expand our distribution relationships and to enhance product mix.

- Rigorous industry-leading program management capabilities
  Our program management begins with a thorough due diligence review of agents' operations and understanding of their historical results. This review is performed by a team of individuals with extensive underwriting, actuarial and claims management expertise.
  We maintain strict control over programs by limiting the claims authority granted to agents and structuring the agents' agreements so that we have all pricing and reinsurance authority. Our program managers have the opportunity to significantly increase their compensation through commission incentives that are strictly tied to underwriting profit on their program.
  Each program manager is subject to regular and vigorous audits to ensure that disciplined underwriting and claims processes are in place and are being followed in accordance with the agreement.

- Strong claims operations tailored to local markets
  We seek to protect our business through diligent claims management. Claims are managed by experienced personnel located in regional operating subsidiaries and by selected program managers. We maintain a culture of rigorously investigating claims, promptly paying legitimate claims, preventing fraud and litigating claims as necessary before final settlement.

- Shared corporate support function

Our corporate structure helps to meet varied local conditions under a cohesive set of policies and procedures designed to provide underwriting discipline, consistency and control. We believe we can derive efficiencies and cost savings by sharing corporate support functions such as investment management, information systems development, purchasing of reinsurance, procurement and office space.

- Outstanding management

Each of our thirteen operating subsidiaries is led by an experienced executive team with expertise in their chosen niche lines of business and extensive knowledge of their local markets. The operating subsidiaries are supported and guided by an executive management team at Kingsway.

CORPORATE STRUCTURE

Through our wholly owned subsidiaries in Canada and the United States, we are licensed to write a broad range of property and casualty insurance in all Canadian provinces and territories and in all states and the District of Columbia in the United States. We distribute our products through independent agents, program managers, and brokers.
We conduct operations through our subsidiaries to, among other things:

- maintain discrete brand identities; and
- develop expertise and organizational cultures that best serve the individual markets in which we operate.

We believe that the markets for our insurance products differ greatly by community because regulations, legal decisions, government influence, traffic, law enforcement, cultural attitudes, insurance agents, medical services and auto repair services vary greatly by jurisdiction and by community.

REVENUES

Premium Income and Competitive Factors

Revenues reflected in our consolidated financial statement are derived from insurance premiums earned, investment income and net realized gains. Total 2007 revenue was $2.04 billion, an increase of 6% over the $1.92 billion from 2006 which was unchanged from 2005.

We compete on the basis of numerous factors such as distribution strength, pricing, agency and broker relationships, service, reputation and financial strength. We are one of the largest non-standard automobile insurers and truck insurers in North America based on A.M. Best data which we have compiled.

In Canada, where we are the largest insurer of non-standard automobile risks, our main competitors are Pembridge Insurance Company, a subsidiary of The Allstate Corporation, and Echelon General Insurance, a subsidiary of EGI Financial Holdings. Our main Canadian competition for trucking is Markel Insurance Company, a subsidiary of Northbridge Financial Corporation.

In our non-standard automobile lines in the United States, we primarily offer policies at the minimum prescribed limits in each state that are typically not greater than $50,000 per occurrence. As a result, we do not directly compete with the larger writers of this product, namely, Progressive, Allstate, State Farm and GEICO

Our primary competitors in this fragmented market are companies such as Bristol West Holdings Inc., a member of Farmers Insurance Group of Companies, Infinity Property and Casualty and Direct General Corporation. In trucking lines, our major competitors in the U.S. are Old Republic General Group, Zurich Financial Services Group, Northland Insurance and Canal Insurance Company.

We compete in both Canada and the United States with numerous smaller insurance companies in regional markets. Many of our larger competitors have greater financial and other resources than we do, more favourable A.M. Best ratings and offer more diversified insurance coverages. In the fragmented non-standard automobile markets in the United States, however, many of our competitors are small companies with limited capital resources that generally have less favourable A.M. Best ratings and who have traditionally relied upon the support of reinsurers to supplement their capital. We believe that recent reinsurance market conditions have led to a contraction of this capital support by reinsurers.

Our competitors include other companies that, like us, serve the independent agency market, as well as companies that sell insurance directly to customers. Direct underwriters typically operate in standard lines of personal automobile and property insurance, where they have certain competitive advantages over agency underwriters. These advantages include increased name recognition obtained through extensive media advertising, loyalty of the customer base to the insurer rather than to an independent agency and, potentially, reduced policy acquisition costs and increased customer retention.

Our markets attract competition from time to time from new entrants in our niche markets. In some cases, these entrants may, because of inexperience, desire for growth or other reasons, price their insurance below the rates that we believe provide an acceptable premium for the related risk. We believe that it is generally not in our best interest to compete solely on price, and may from time to time experience a loss of market share during periods of intense price competition or "soft" market conditions.

We believe that our ability to compete successfully in our industry will be based on our:

- ability to identify specialty markets that are more likely to produce an underwriting profit;
- disciplined underwriting approach;
- diversified product and geographic platforms;
- prudent claims management;
- rigorous approach to reserving for unpaid claims;
- cost containment and the economics of shared support functions; and
- services and competitive commissions we provide to our independent agents, program managers and brokers.

Any new, proposed or potential legislative or industry developments could increase competition in our markets or reduce our ability to price risks appropriately. New competition from these developments could cause the prices for insurance to fall, which would adversely affect our underwriting profitability.

Our underwriting philosophy stresses receiving an adequate premium and spread of risks for the business we accept. Rather than attempt to select individual risks, we seek to set premium rates at levels that should generate profitable underwriting. Once we have set premium rates that we believe are adequate, we are generally willing to accept as much business within our underwriting guidelines as is available to us. We regularly monitor premium adequacy by territory and class of business and make adjustments as required. We do not reduce our pricing when competitors offer to underwrite certain classes of business at premium rates that are below what we believe are acceptable levels. Instead, we elect to maintain our premium per risk rather than write a large number of risks at premiums that we consider to be inadequate. In such instances, our premium volumes may decrease. Underwriting profitability is primarily dependent on the claims amounts incurred on the policies sold in relation to net premiums earned. At the time premium levels are established, the claims amounts to be incurred on the policies sold are unknown, and the process for estimating claims is inherently uncertain and imprecise.

We regularly consider and implement various initiatives to address adverse profitability trends in our business. These initiatives vary by jurisdiction, but include tightening of underwriting requirements, price increases, termination of underperforming programs, reduction in agent commissions, policy non-renewals (where permitted) and other administrative changes. All companies writing automobile insurance in Canada and all lines of business in most U.S. jurisdictions must have their premium rates approved by the applicable regulatory authority. Once these rates are approved, an insurance company is prohibited from altering them without regulatory approval for new rates.

We market and distribute our automobile insurance products through a network of approximately 9,000 independent agents and approximately 30 program managers in the United States and over 3,000 independent brokers across Canada. We maintain an "open market" approach which allows these agents and brokers to place business with us with no minimum commitments and provides us with a broad, flexible and easily scalable distribution network. We believe that this approach is different from that used by many automobile insurance companies.

We focus on developing and maintaining strong relationships with our independent agents, program managers and brokers. We continually strive to provide excellent service in the local markets in which we operate, and to communicate with them through a variety of channels as we look for opportunities to increase efficiency and reduce operating costs.

Our independent agents, program managers and brokers generally have the authority to bind policies on our behalf with respect to specified insurance coverages within our prescribed underwriting guidelines. These guidelines prescribe the kinds and amounts of coverage that may be written and the premium rates that may be charged for specified categories of risk. In most cases, we do not delegate authority to settle or adjust claims, establish underwriting guidelines, develop rates or enter into other transactions or commitments with our independent agents, program managers or brokers. Certain of our program managers have greater authority than other independent agents and brokers. These program manager relationships are subject to a rigorous audit process to ensure that they adhere to our underwriting standards and claims handling procedures.

Gross premiums written were $1.96 billion in 2007, compared to $1.93 billion in 2006. In 2007, we experienced a decrease of 4% in gross premiums written in our Canadian operations, offset by a 4% increase in our U.S. operations. Our personal lines business accounted for 48% of our gross premiums written for the year ended December 31, 2007 and 52% were generated from our commercial lines.

Table 2 and Table 3 on the following page set forth our gross premiums written by line of business and by geographic region respectively, for the periods indicated.

Our automobile insurance products provide coverage in three major areas: liability, accident benefits and physical damage. Liability insurance provides coverage, where our insured is responsible for an automobile accident, for the payment for injuries and property damage to third parties. Accident benefit policies or personal injury protection policies provide coverage for loss of income, medical and rehabilitation expenses for insured persons who are injured in an automobile accident, regardless of fault. Physical damage coverages provide for the payment of damages to an insured automobile arising from a collision with another object or from other risks such as fire or theft. Automobile physical damage and liability coverages generally provide more predictable results than automobile personal injury insurance.

Non-Standard Automobile

Non-standard automobile insurance accounted for 31% and 26% of our gross premiums written for the years ended December 31, 2007 and 2006, respectively. Non-standard automobile insurance is principally provided to individuals 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. Such drivers typically represent higher than normal risks and pay higher insurance rates for comparable coverage.

Non-standard automobile insurance is generally accompanied by increased loss exposure, higher claims experience and a higher incidence of consumer and service provider fraud. In addition, policy renewal rates tend to be low for non-standard automobile policies as policyholders often lapse their policies because of non−payment of premiums and subsequently reapply as new policyholders. This creates an on-going requirement to replace non-renewing policyholders with new policyholders and to react promptly to issue cancellation notices for non-payment of premiums to mitigate potential bad debt write-offs. These factors, however, are mitigated to some extent by higher premium rates, the tendency of high-risk individuals to own low value automobiles, and generally lower limits of insurance coverage as insureds tend to purchase coverage at the minimum prescribed limits.

The insuring of non-standard drivers is often transitory. When their driving records improve, insureds may qualify to obtain insurance in the standard market at lower premium rates. We often cancel policies for non-payment of premium and, following a period of lapse in coverage, insureds frequently return to purchase a new policy at a later date. As a result, our non-standard automobile insurance policies experience a retention rate that is lower than that experienced for standard market risks. Most of our insureds pay their premiums on a monthly instalment basis and we typically limit our risk of non-payment of premiums by requiring a deposit for future insurance premiums and the prepayment of subsequent instalments.

In the United States and Canada, automobile insurers are generally required to participate in various involuntary residual market pools and assigned risk plans that provide automobile insurance coverage to individuals or other entities that are unable to purchase such coverage in the voluntary market. For example, in Ontario and Alberta, every insurer is required to be a member of that province's Facility Association, an entity that was created to ensure the availability of automobile insurance to every motorist. Each Facility Association selects designated carriers to provide coverage and claims handling services to drivers who are unable to purchase insurance through private carriers, in return for an administration fee. Participation in these pools in most jurisdictions is in proportion to voluntary writings of selected lines of business in that jurisdiction.

In January 2007, we completed the acquisition of the assigned risk business of The Robert Plan Corporation and established an agency called Robert Plan Corporation Insurance Agency (“RPCIA”) to operate this business. In states where non-standard automobile risks are assigned to standard automobile insurance companies, RPCIA offers to assume these assigned risks from the standard insurer, underwritten by one of our other subsidiaries, for a pre-agreed buy-out fee. During soft markets, the assigned risk business tends to shrink as standard insurers are more willing to retain the assigned risk business. As a result, the assigned risk pool in 2007 was lower than in recent years but is expected to increase as the market hardens which we believe could begin in late 2008.

In Canada, we are the largest writer of non-standard automobile insurance and operate primarily in Ontario, Québec and Alberta, with Ontario being our largest market in 2007. The non-standard automobile insurance market in Canada is primarily focused on providing drivers with minimum levels of liability coverage and accident benefit insurance.

In the United States, we write non-standard automobile insurance in various states, predominantly California, New York, Illinois, and Florida. In the United States, non-standard automobile insurance policies generally have lower limits of insurance commensurate with the minimum coverage requirement under the statute of the state in which we write the business. These limits of liability are typically not greater than $50,000 per occurrence.

In early 2007, we acquired Mendota which is a dedicated non-standard insurance provider licensed in 43 states and currently writes business in 20 states through a network of approximately 6,000 independent agency locations.

Trucking

We provide coverage for liability, accident benefits, physical damage, cargo and comprehensive general liability under a package program throughout both Canada and the United States as many of our insured trucks travel throughout both countries. In Canada, we may offer policies with limits of liability of up to C$10 million. We then purchase reinsurance to limit our exposure for any one risk or occurrence to C$2.5 million. In the United States we do not offer primary liability policies for trucking liability in excess of $1.0 million per risk. In both Canada and the U.S., we target smaller fleets and owner/operators where competition is generally lower than for large fleets and where pricing is generally more rational. We distribute our policies through program managers in the U.S. and through independent brokers in Canada.

TABLE 2 Gross premiums written by line of business

For the year ended December 31 (in millions of dollars, except for percentages)

			2007			2006
Non-Standard Automobile	$	617.0	31.4%	$	498.4	25.8%
Standard Automobile		90.8	4.7		108.5	5.6
Motorcycle		81.0	4.1		68.7	3.5
Property (including liability)		120.6	6.1		121.0	6.3
Other Specialty Lines		29.8	1.6		32.9	1.7
Total Personal	$	939.2	47.9%	$	829.5	42.9%
Trucking	$	416.6	21.2%	$	634.2	32.8%
Commercial Automobile		322.8	16.4		269.9	14.0
Property (including liability)		201.2	10.3		137.4	7.1
Other Specialty Lines		82.9	4.2		61.7	3.2
Total Commercial	$	1,023.5	52.1%	$	1,103.2	57.1%
Total Gross Premiums Written	$	1,962.7	100.0%	$	1,932.7	100.0%

TABLE 3 Gross premiums written by state and province

For the year ended December 31 (in millions of dollars, except for percentages)

2007	2006

California	$	272.8	13.9%	$	263.5	13.6%
Florida		188.6	9.6		183.0	9.5
Illinois		166.4	8.5		189.7	9.8
New York		129.7	6.6		88.1	4.6
Texas		99.8	5.1		110.2	5.7
Hawaii		74.1	3.8		66.3	3.4
New Jersey		43.9	2.2		49.4	2.5
Other		417.4	21.3		391.8	20.3
Total United States	$	1,392.7	71.0%	$	1,342.0	69.4%
Ontario	$	362.7	18.4%	$	372.6	19.3%
Québec		122.3	6.2		113.7	5.9
Alberta		46.5	2.4		70.6	3.7
Other		38.5	2.0		33.8	1.7
Total Canada	$	570.0	29.0%	$	590.7	30.6%
Total	$	1,962.7	100.0%	$	1,932.7	100.0%

In the year ended December 31, 2007, gross premiums written from trucking insurance declined 34% to $416.6 million as a result of competitive market conditions in Canada and the U.S. and due to the cancellation of unprofitable programs by Lincoln General. Trucking insurance accounted for 21% and 33% of our gross premiums written for the years ended December 31, 2007 and 2006, respectively.

Commercial Automobile

Commercial automobile policies provide coverage for taxis, rental car fleets and garage risks. In the year ended December 31, 2007, gross premiums written from commercial automobile increased by 20% to $322.8 million compared to $269.9 million in 2006.

Standard Automobile

Standard automobile insurance provides coverage for standard risk drivers of private passenger automobiles. Premiums for these types of policies are usually lower than premiums charged in the non-standard market for comparable coverages. The frequency and severity of accidents and other loss events, however, are also typically lower. Our standard automobile business is written in Ontario and Alberta. In the year ended December 31, 2007, gross premiums written from standard automobile decreased by 16% to $90.8 million compared to $108.5 million in 2006 due to competitive market conditions.

Motorcycle

Motorcycle insurance consists primarily of liability, physical damage and personal injury insurance coverages. In Canada, we are the leading writer of motorcycle insurance, with over 30% of the total market, and we write motorcycle insurance in the provinces of Ontario, Alberta and Québec. We also write motorcycle insurance in the United States. In the year ended December 31, 2007, gross premiums written from motorcycle insurance increased by 18% to $81.0 million compared to $68.7 million in 2006.

Property (including liability)

We write property (including liability) insurance for businesses and individuals in Canada and the United States. This business focuses primarily on insuring against damage to property and accidents that may occur on such property. Our commercial property and liability business consists of risks that are either difficult to place due to class, age, location or occupancy of the risk or are associated with risks within our core lines. These risks are characterized by high premiums and limited coverage. We generally limit our exposure on commercial property to no more than C$1.0 million in Canada and $0.5 million in the United States on any one risk.

Our specialty property business includes insurance for restaurants, rental properties and garages. We also write non-hydrant protected homeowners' insurance and habitational risks that do not qualify for coverage by writers of standard insurance. We write liability insurance for artisan contractors which, subject to all insurance policy terms and conditions, may provide limited coverage and/or a duty to defend construction defect claims in the State of California. Loss adjustment expenses represent a higher proportion of the total claims expense on this business as compared to other exposures we write. Construction defect claims may be filed for a significant period of time from the date of the occurrence giving rise to the loss claimed, as prescribed by California law. In the year ended December 31, 2007, gross premiums written from the artisan contractors program were $67.2 million compared to $75.3 million in 2006. We provide coverage on a very itemized named perils basis with relatively high rates and high deductibles for risks that are considered substandard by other companies. We believe these risks provide us with the opportunity to achieve attractive returns.

In late 2005, we acquired Zephyr Insurance Company, Inc., a provider of residential wind insurance coverage in the state of Hawaii. Zephyr's operating niche complements our core strategy of providing products and services to specific, defined segments of the insurance marketplace. Zephyr is protected by a reinsurance program further described in the reinsurance section of Management's Discussion and Analysis.

Our strategy is to operate as a niche underwriter of classes of property business that are more difficult to underwrite and offer the potential to achieve higher levels of underwriting profitability. We underwrite this business using our carefully developed underwriting methodology based on a stringent set of criteria. This type of property business is seldom subject to a high degree of competition and we have often been able to write these policies at relatively high rates with fairly restricted coverage.

Other Specialty Lines

Other specialty lines include customs, bail and surety bonds written in both the United States and Canada. Customs bonds involve insuring the timely payment of customs duties on goods imported into the United States and Canada, as well as any penalties incurred due to late payment of the duties or administrative non-compliance. Such duties generally represent less than 5% of the face value of the imported goods. We also write contract payment and performance and other miscellaneous surety bonds as well as bail bonds in California.

INVESTMENT SECURITIES AND INVESTMENT INCOME

Overview and Strategy

Our business philosophy stresses the importance of both underwriting profits and investment returns to build shareholder value. We manage our securities portfolio to support the liabilities of our insurance operations and to generate investment returns. We invest predominantly in corporate and government bonds with relatively short durations. We also invest in preferred and common equity securities and other interest-bearing instruments, and we consider our financed premium receivables to be a part of our securities portfolio. Our overall investment strategy is aimed at maximizing returns without compromising liquidity and risk control. Virtually all of our securities are managed by third party investment management firms and their performance is actively monitored by management and the Investment Committee of the Board of Directors.

Our investment guidelines stress the preservation of capital, market liquidity to support payment of our liabilities and the diversification of risk. With respect to fixed income securities, we generally purchase securities with the expectation of holding them to their maturities.

Our conservative securities portfolio has resulted in very little exposure to the U.S. sub-prime residential mortgage market. As at December 31, 2007, this exposure was limited to approximately $3.5 million in home equity loan asset backed securities rated ‘AAA’ by Standard & Poors (“S&P”) with an unrealized loss of approximately $0.1 million. As at December 31, 2007 the securities portfolio did not include any collateralized debt obligations nor any direct exposure to asset backed commercial paper.

Portfolio Composition

At December 31, 2007, we held cash and securities (including financed premiums) with a fair value of $3.51 billion and an amortized cost of $3.48 billion, resulting in net unrealized gains of $34.6 million. We currently hold and intend to maintain a securities portfolio comprised primarily of fixed income securities. Insurance subsidiaries’ securities must comply with applicable regulations that prescribe the type, quality and concentration of securities. These regulations in the various jurisdictions in which our insurance subsidiaries are domiciled, permit investments in government, state, provincial, municipal and corporate bonds, and preferred and common equities, within specified limits and subject to certain qualifications. Our U.S. operations typically invest in U.S. dollar denominated securities, and our Canadian operations primarily invest in Canadian dollar denominated securities to mitigate their exposure to currency rate fluctuations.

Table 4 below summarizes the fair value of our securities portfolio, including cash and cash equivalents and financed premiums, at the dates indicated.

TABLE 4 Fair value of securities portfolio

For the year ended December 31 (in millions of dollars)

	2007	2006
Type of security		
Term deposits	$ 394.6	$ 379.1
Government bonds	372.3	333.2
Corporate debt securities	2,047.7	1,771.5
Subtotal	$ 2,814.6	$ 2,483.8
Common shares	$ 434.7	$ 404.2
Preferred shares	7.1	-
Finance premiums	91.9	67.5
Cash and cash equivalents	161.6	129.8
Total	$ 3,509.9	$ 3,085.3

TABLE 5 Investment results before the effect of income taxes
For the year ended December 31 (in millions of dollars)

	2007	2006
Average securities at cost	$ 3,297.8	$ 3,013.6
Investment income after expenses	$ 141.5	$ 120.9
Percent earned on average investments (annualized)	4.3%	4.0%
Net realized gains	$ 52.1	$ 29.0
Total investment income	$ 193.6	$ 149.9
Total realized yield	5.9%	5.0%
Change in unrealized investment gains	$ 8.1	$ 8.3
Total return yield	6.1%	5.2%

TABLE 6 Fair value by contractual maturity date of our fixed income securities portfolio
For the year ended December 31 (in millions of dollars)

	2007		2006	
Due in less than one year	$ 714.3	25.4%	$ 600.0	24.2%
Due in one through five years	1,242.7	44.1	1,157.5	46.5
Due after five through ten years	720.5	25.6	590.9	23.8
Due after ten years	137.1	4.9	135.4	5.5
Total	$ 2,814.6	100.0%	$ 2,483.8	100.0%

The fair value of equity securities represented 12% of our securities portfolio at December 31, 2007, compared with 13% at December 31, 2006.

Investment results before the effect of income taxes are reflected in Table 5 above.

Investment income, including net realized gains, increased by 29% to $193.6 million in 2007, compared to $149.9 million in 2006. The percentages earned on average securities shown in Table 5 compare with the Lehman Brothers Eurodollar Aa or Higher 1-5 Years Index of 7.1% and 4.4% for the DEX 1-5 Year Euro Canadian Index, 5.5% for the S&P 500 Index and 9.8% for the S&P TSX Index for the twelve months ended December 31, 2007.

Table 6 above summarizes the fair value by contractual maturities of our fixed income securities portfolio, excluding cash and cash equivalents, at the dates indicated.

At December 31, 2007, 70% of our fixed income securities, including treasury bills, bankers' acceptances, government bonds and corporate bonds had contractual maturities of five years or less compared to 71% as at December 31, 2006. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call or prepayment penalties. Currently, we maintain a liquid portfolio to ensure there is sufficient cash available for the payment of claims on a timely basis. We believe that our high quality, liquid securities portfolio provides us with sufficient liquidity to meet obligations to our policyholders.

Table 7 below summarizes the composition of the fair value of our fixed income securities portfolio, excluding cash and cash equivalents, at the dates indicated, by rating as assigned by S&P or Moody's Investors Service, using the higher of these ratings for any security where there is a split rating. Our fixed income securities portfolio consists of predominantly very high quality securities in corporate and government bonds with greater than 94% rated 'A' or better.

TABLE 7 Credit ratings of fixed income securities portfolio
As at December 31

	2007	2006
Rating		

AAA/Aaa	53.9%	54.0%
AA/Aa2	23.5%	24.1%
A/A2	16.7%	17.8%
Percentage rated A/A2 or better	94.1%	95.9%
BBB/Baa2	3.4%	2.8%
BB/Ba2	0.3%	0.4%
B/B2	0.4%	0.6%
CCC/Caa or lower, or not rated	1.8%	0.3%
Total	100.0%	100.0%

Table 8 below shows how the fair value of our securities portfolio (including cash and cash equivalents and financed premiums) and cash flow from operations has grown over the last ten years.

TABLE 8 Fair value of our securities portfolio and cash flow from operations

	Securities Portfolio at Fair Value (in millions)	Securities Portfolio Per Share Outstanding (in dollars)	Cash Flow Generated from Operations (in millions)
1998	$ 409	$ 11.40	$ 43
1999	457	13.43	23
2000	522	15.32	62
2001	775	15.92	134
2002	1,346	27.59	382
2003	2,124	38.04	471
2004	2,644	47.04	392
2005	2,933	51.93	274
2006	3,085	55.21	167
2007	3,510	63.22	67

Market Risk

Market risk is the risk that we will incur losses due to adverse changes in interest or currency exchange rates and equity prices. Our primary market risk exposures are to changes in interest rates and equity prices. We have a smaller exposure to changes in the U.S. to Canadian dollar foreign currency exchange rate.

Because most of our securities portfolio is comprised of fixed income securities that are usually held to maturity, periodic changes in interest rate levels generally impact our financial results to the extent that reinvestment yields are different than the original yields on maturing securities. During periods of rising interest rates, the market value of our 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.

Duration is a measure used to estimate the extent to which market values change with changes in interest rates. Using this measure, it is estimated that an immediate hypothetical 100 basis point parallel increase in interest rates would decrease the market value of our fixed income securities by $92.3 million, representing 3.3% of the $2,814.6 million fair value fixed income securities portfolio.

Fluctuations in value of our equity securities due to changes in general economic or stock market conditions affect the level and timing of recognition of gains and losses on securities we hold, causing changes in realized and unrealized gains and losses.

We do not hedge any foreign currency exposure that may exist in the securities portfolio. Our U.S. operations generally hold their investments in U.S. dollar denominated securities, and our Canadian operations in Canadian dollar denominated securities.

Credit Risk

Credit risk is defined as the risk of financial loss due to failure of the other party to a financial instrument to discharge an obligation. Credit risk arises from our positions in term deposits, corporate debt securities and government bonds. The Investment Committee of the Board of Directors is responsible for the oversight of key investment policies and limits. These policies and limits are subject to annual review and approval by the Investment Committee. The Investment Committee is also responsible for ensuring that these policies are implemented and that procedures are in place to manage and control credit risk.

The company has policies to limit and monitor its exposure to individual issuers or related groups (with the exception of U.S. and Canadian government bonds).

Premiums for property and casualty insurance are typically payable at the time a policy is issued in force or renewed. To assist insureds in making their payments, in some instances we offer premium financing either directly or through a separate premium finance company, whereby the insured can pay a portion of the premium in monthly instalments. The insured pays an additional amount for this option, reflecting handling costs and the income we would have earned on such premium, had we received the total amount at the beginning of the policy period. We typically collect sufficient premiums in advance of the period of risk which ensures that in the event of payment default by the insured, we should not have uncollectible balances. The option of monthly premium payments is available only where permitted under the laws or regulations of the specific jurisdictions. Some jurisdictions require the option of monthly premium payments at a specific annual interest rate or monthly charge.

Certain U.S. public companies include this premium finance income in computing their combined ratio and underwriting profit. We, however, consider our income from premium finance activities to be a part of investment income, because this additional amount is essentially an interest payment on the balance of unpaid premium. At December 31, 2007, the balance of our financed premiums receivable was $91.9 million compared to $67.5 million at December 31, 2006.

The fair value of financed premiums approximates their carrying amount.

Portfolio Monitoring

Virtually all of our securities are managed by third-party investment management firms and we monitor their performance and their compliance with their individual mandate and the Company's investment policies and guidelines. We have engaged Conning Asset Management, Royal Bank of Canada (Caribbean), Deans Knight Capital Management Limited and J. Zechner Associates Inc. to oversee the majority of the fixed income securities portfolio. In addition, Burgundy Asset Management, Burgundy International Asset Management, Deans Knight Capital Management Limited, Kingwest and Company, Marquest Investment Counsel, SFE Investment Counsel and Wellington Management Company have each been engaged to manage portions of our subsidiaries' equity securities portfolios.

The Company has recognized losses on securities for which a decline in market value was deemed to be other than temporary. We recognized charges of $20.4 million, $4.6 million and $4.8 million for securities value impairment that was considered other than temporary for the years ended December 31, 2007, 2006 and 2005, respectively. The charges recognized in 2007 reflected the impact on the securities portfolio of the unusually volatile equity markets in 2007. In determining whether a decline in value of a security is other than temporary, the Company has applied Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities.

We perform a quarterly analysis of our securities holdings to determine if declines in market value are other than temporary. The analysis includes some or all of the following procedures:

- identifying all security holdings in an unrealized loss position that has existed for at least six months or that other circumstances exist where management believes those circumstances 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 and experience together with 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 the investment grade credit rating from third party security rating agencies;
- assessing if declines in market value are other than temporary for any debt security holding with a non-investment grade credit rating based on the continuity of its debt service record; and
- determining the necessary provision for declines in market value that are considered other than temporary based on the analyses performed.

The risks and uncertainties inherent in the assessment methodology used 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 a company's unknown underlying financial problems.

The length of time securities may be held in an unrealized loss position may vary based on the opinion of our appointed investment managers and their respective analyses related to valuation and to the various credit risks that may prevent us from recapturing our principal investment. In cases of securities with a maturity date where our appointed investment manager determines that there is little or no risk of default prior to the maturity of a holding, we would elect to hold the security in an unrealized loss position until the price recovers or the security matures. In situations where facts emerge that might increase the risk associated with recapture of principal, securities may be traded and losses realized.

Due to the inherent volatility of equity markets, we believe there are securities that trade from time to time below their intrinsic values based on historical valuation measures. In these situations, holdings may be maintained in an unrealized loss position for different periods of time based on the underlying economic assumptions driving the investment manager's valuation of the holding.

At December 31, 2007 and December 31, 2006, the gross unrealized losses amounted to $43.8 million and $40.3 million, respectively. Unrealized losses attributable to non-investment grade fixed income securities at December 31, 2007 and December 31, 2006 were $2.3 million and $0.2 million, respectively.

At December 31, 2007 and December 31, 2006, unrealized losses related to government bonds and term deposits were considered temporary as there was no evidence of default risk. Corporate bonds, even those below investment grade, in a material unrealized loss position, continued to pay interest and were not subject to material changes in their respective debt ratings. We concluded that a default risk did not exist at the time and, therefore, the decline in value was considered temporary. As we have the capacity to hold these securities to maturity, no impairment provision was considered necessary. In making our impairment decisions, we utilized the professional expertise of our investment advisors, analyzed independent economic indicators and reviewed stock market trends. In deciding whether to reduce the carrying value of common shares, we take into account a number of factors, including whether the decline in market value is more than 20% and has persisted for a period exceeding six months. Common stock positions in an unrealized loss position for more than six months may not be considered impaired based on the underlying fundamentals of the specific holdings. In the case of fixed income securities, we also take into account whether the issuer is in financial distress (unable to pay interest or some other situation that would put in question the issuer's ability to satisfy its debt obligations).

PROVISION FOR UNPAID CLAIMS

Overview

Claims management is the procedure by which an insurance company determines the validity and amount of a claim. We focus on rigorous claims management.

We investigate the actual circumstances of the incident that gave rise to the claim and the actual loss suffered. An important part of claims management is verifying the accuracy of the information provided to the insurance company at the time the policy is underwritten.

The nature of non-standard automobile and trucking insurance typically requires more thorough claims management and in particular, more thorough investigative procedures and greater defence costs than many other types of insurance. Insurance claims on our policies are investigated and settled by our local claims adjusters, and we may also employ independent adjusters, private investigators, various experts and legal counsel to adjust claims. We believe that effective claims management is fundamental to our operations.

Reserving

A provision for unpaid claims includes several components: a provision for unpaid claims based on estimated liability on individual reported claims (more commonly known as case reserves), an estimated provision for claims that have not yet been reported and expected future development on case reserves, collectively known as the incurred but not reported claims provision ("IBNR"). The provision for unpaid claims also includes an estimate of allocated loss adjustment expenses (primarily defence costs) and unallocated loss adjustment expenses (primarily the adjustment handling costs by claims personnel) which we expect to incur in the future.

The establishment of a provision for unpaid claims represents management’s best estimate of the ultimate cost of both reported but unsettled claims and unreported claims. The provision for unpaid claims does not represent an exact calculation of the liability but instead represents management’s best estimate at a given accounting date utilizing actuarial and statistical procedures. The provision for unpaid claims represents the undiscounted estimates of the ultimate net cost of all unpaid claims and loss adjustment expenses. Management continually reviews its estimates and adjusts as experience develops and new information becomes available. In establishing the provision for unpaid claims, the Company also takes into account estimated recoveries, reinsurance, salvage and subrogation.

The process for establishing the provision for unpaid claims reflects the uncertainties and significant judgemental factors inherent in predicting future results of both known and unknown claims. As such, the process is inherently complex and imprecise and estimates are constantly refined. The process of establishing the provision for unpaid claims relies on the judgement and opinions of a large number of individuals, including the opinions of the external independent appointed actuary, Towers Perrin Inc.

Factors affecting the provision for unpaid claims include the continually evolving and changing regulatory and legal environments, actuarial studies, professional experience and the expertise of our claims personnel and independent adjustors retained to handle individual claims. A change in claims handling procedures and changes in individuals involved in the reserving process can also affect the provision for unpaid 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, all affect the provision for unpaid claims.

In addition, time can be a critical part of the provisions' determination, because 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-tailed claims, such as property claims, tend to be more predictable than long-tailed claims, such as general liability and automobile accident benefit claims, which are less predictable because short-tail claims are reported and settled quickly, resulting in less estimation variability. We do not have exposure to asbestos or environmental liability other than pollution coverage for oil spills as required for trucking insurance. Our provision for unpaid claims is not discounted to reflect the time value of expected future payouts of claims.
Table 9 below shows the amounts of total case reserves and IBNR as at December 31, 2007 and 2006. During 2007, U.S. operations increased case reserves by 12% and increased IBNR reserves by 27% with an increase of 18% in total reserves compared to December 31, 2006. An explanation for the increases in the U.S. operations total reserves is included in the "Changes in Methodology During 2007" section below. Our Canadian operations increased case reserves by 13%, IBNR by 19% and total reserves by 15% in U.S. dollars. The Canadian operations total reserves were impacted by the strengthening of the Canadian dollar. In Canadian dollars, the total reserves for the Canadian operations decreased 2%.

TABLE 9 Total case reserves and IBNR
For the year ended December 31 (in thousands of dollars)

	2007	2006	(%) Increase
U.S. Operations			
Case Reserves	$ 732,861	$ 656,383	12%
IBNR	610,128	482,024	27%
Total unpaid claims	$ 1,342,989	$ 1,138,407	18%
Canadian Operations			
Case Reserves	$ 581,404	$ 512,769	13%
IBNR	342,689	288,187	19%
Total unpaid claims	$ 924,093	$ 800,956	15%
Consolidated unpaid claims	$ 2,267,082	$ 1,939,363	17%

Impact of Changes in Provision for Unpaid Claims
Any adjustments are reflected in our consolidated statement of operations in the period in which they become known and are accounted for as changes in estimates. Even after such adjustments, ultimate liability or recovery may exceed or be less than the revised estimates. A change that increases the provision for unpaid claims is known as an unfavourable change and will reduce net income.

Management Process
Management of each operating insurance company has the responsibility to ensure that the provision for unpaid claims, including IBNR, are appropriate. Each operating insurance company separately establishes, maintains and evaluates its respective provisions for unpaid claims for statutory reporting purposes. Each company evaluates all of its respective policy coverages and paid and open claim level data to ascertain claim frequency and severity trends, as well as the effects, if any, inflation or changes in operating structure or process may have on future loss settlements. Management reviews the information by its product and geographic regions to monitor emergence of any patterns. Management incorporates all of the above information to record its best estimate of the provision for unpaid claims. Management also uses actuarial and statistical procedures to allocate the IBNR by accident years and coverages.

External Actuarial Process
An external independent actuary, Towers Perrin Inc., is appointed for each operating insurance company to ascertain whether the provision for unpaid claims as established by management is reasonably stated and within the appointed

independent actuary's range of reserve estimates. As these processes are undertaken independently, the provision for unpaid claims recorded by management can differ from the actuary's point estimate. The Company has established a policy that, to the extent that management's estimate of its gross provision for unpaid claims (net of salvage and subrogation) are less than the point estimate as recommended by their independent appointed actuary, the Company requires management to increase the gross provision for unpaid claims to an amount that is not less than the point estimate as recommended by the independent appointed actuary. As part of the Company's reserving process, the external independent actuary will perform various quarterly reviews throughout the calendar year to assess whether the actual results of the operating insurance company are not materially different than what was expected based on loss development factors previously established.

Both internal and external actuaries have to exercise a considerable degree of judgement when evaluating the factors and assumptions in analyzing the reserves. Different actuaries may choose different assumptions when faced with uncertainty, based on their individual backgrounds, professional experiences and areas of focus. As a result, the estimate selected by one actuary may differ significantly from that of another actuary.

In accordance with actuarial standards for 2007 and 2006, the independent appointed actuary develops a variability of the reserve estimates, more commonly known as a range of reserve estimates, and a recommended point estimate of reserves. The point estimate is intended to represent the independent appointed actuary's best estimate and will not necessarily be at the mid-point of the high and low estimates of the range.

The variability of reserve estimates for gross unpaid claims for our U.S. and Canadian operations estimated by our independent appointed actuary, the point estimate as recommended by the external independent appointed actuary and the actual carried provision for unpaid claims are shown below in Table 10.

Table 11 on the next page summarizes the provision for unpaid claims, net of recoveries from reinsurers, established as at the end of the years 1997 through 2006 and compares the re-estimation of those liabilities as at December 31, 2007. This table presents the development of unpaid claims liabilities reflected on our balance sheets as at each year end December 31, 1997 through December 31, 2007. The top line of the table presents the estimated provision for unpaid claims recorded at the balance sheet date for each of the indicated years. This provision represents the estimated amount of losses and loss adjustment expenses for claims unpaid at the balance sheet date, including losses that have been incurred and not reported. The table also presents the re-estimated provision for unpaid claims on a gross basis, with separate disclosure of the re-estimated reinsurance recoverables on unpaid claims for years 1997 through 2006.

The development of the provision for unpaid claims is shown by the difference between estimates of claims as of the initial year end and the re-estimated liability at each subsequent year end. This is based on actual payments in full or partial settlement of claims, plus re-estimates of the payments required for claims still open or claims still unreported. Favourable development (reserve redundancy) means that the original claim estimates were higher than subsequently determined. Unfavourable development (reserve deficiency) means that the original claim estimates were lower than subsequently determined.

The table presents the cumulative amount paid with respect to the previously recorded provision as of the end of each succeeding year and the re-estimated amount of the previously recorded provision based on experience as of the end of the succeeding year. The estimate is increased or decreased as more information about the claims becomes known for individual years. For example, as of December 31, 2007, we had paid $926.7 million of the currently estimated $1,020.9 million of claims that had been incurred through the end of 2002; thus an estimated $94.2 million of losses incurred prior to December 31, 2002 remain unpaid as of December 31, 2007.

The cumulative development represents the aggregate change in the estimates over all prior years. For example, unpaid claims at December 31, 1997 have developed adversely by $11.8 million over the subsequent ten years and unpaid claims at December 31, 1999 have developed adversely by $60.8 million over the subsequent eight years. The effect on income during the past three years due to changes in estimates of unpaid claims is shown in Note 12(b) to the consolidated financial statements as the "prior years" contribution to incurred losses.

Each cumulative development amount includes the effects of all changes in amounts during the current year for prior periods and the impact of currency translation. For example, the amount of the development related to losses settled in 2007, but incurred in 2000, will be included in the cumulative development amounts for years 2000, 2001, 2002, 2003, 2004, 2005 and 2006. The deficiency identified during the year 2007 of $180.4 million was attributable to unpaid claims as at December 31, 2006 for unpaid claims for the year 2006 and all prior years.

TABLE 10 Comparison of actuarial ranges for gross unpaid claims
As of December 31, 2007 (in millions of dollars)

	Low	High	Point Estimate	Carried
U.S. Operations	$ 1,201.2	$ 1,490.7	$ 1,332.4	$ 1,343.0

Canadian Operations		813.0		1,039.6		921.6		924.1
Total Consolidated Provision for Unpaid Claims	$	2,014.2	$	2,530.3	$	2,254.0	$	2,267.1

As of December 31, 2006 (in millions of dollars)

		Low		High		Point Estimate		Carried
U.S. Operations	$	991.0	$	1,274.9	$	1,132.4	$	1,138.4
Canadian Operations		684.2		915.3		800.0		801.0
Total Consolidated Provision for Unpaid Claims	$	1,675.2	$	2,190.2	$	1,932.4	$	1,939.4

TABLE 11 Provision for unpaid claims, net of recoveries from reinsurers
As at December 31, 2007 (in millions of dollars, except percentages)

	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Unpaid claims originally established -end of year, gross	2,267.1	1,939.4	1,844.2	1,689.2	1,310.6	765.3	358.4	287.6	306.4	291.6	132.
Less: Reinsurance recoverable on unpaid losses	177.7	176.5	181.6	225.9	122.0	85.6	64.4	61.7	83.1	88.0	44.
Unpaid claims originally established -end of year, net	2,089.4	1,762.9	1,662.6	1,463.3	1,188.6	679.7	294.0	225.9	223.3	203.6	87.
Cumulative paid (net of currency translation impact) as of:											
One year later		699.8	740.6	652.1	584.9	319.8	190.6	123.4	102.0	84.2	35.
Two years later			1,148.7	1,080.7	961.6	588.7	264.5	197.0	159.9	134.5	52.
Three years later				1,336.4	1,198.4	774.2	361.0	237.5	206.0	171.1	64.
Four years later					1,327.9	875.3	428.3	284.2	224.4	198.5	76.
Five years later						926.7	460.5	313.4	248.0	205.0	85.
Six years later							476.6	326.4	263.3	217.4	86.
Seven years later								334.1	267.5	225.1	89.
Eight years later									272.0	226.2	93.
Nine years later										228.6	92.
Ten years later											93.
Re-estimated liability as of:											
One year later		1,943.3	1,726.9	1,487.5	1,241.8	818.2	363.5	246.2	220.1	198.5	78.
Two years later			1,906.9	1,645.7	1,399.7	915.4	424.1	274.5	228.2	200.5	80.
				1,740.1	1,480.9	984.7	475.4	313.5	241.1	206.5	82.

Three years later										
Four years later				1,520.8	1,007.3	496.8	335.4	263.8	217.2	85.
Five years later					1,020.9	505.5	343.2	274.1	226.1	90.
Six years later						509.6	345.8	275.4	230.7	94.
Seven years later							354.0	276.8	231.7	96.
Eight years later								284.0	233.5	96.
Nine years later									239.0	97.
Ten years later										99.
As at December 31, 2007: Cumulative (redundancy) deficiency	180.4	244.4	276.8	332.1	341.2	215.6	128.1	60.8	35.4	11.
Cumulative (redundancy) deficiency as a % of reserves originally established - net	10%	15%	19%	28%	50%	73%	57%	27%	17%	1
Re-estimated liability - gross	2,093.0	2,079.1	1,982.6	1,692.1	1,162.8	607.5	420.7	368.1	338.1	141.
Less: Re-established reinsurance recoverable	149.7	172.2	242.5	171.3	141.9	98.0	66.7	84.0	99.1	42.
Re-estimated provision - net	1,943.3	1,906.9	1,740.1	1,520.8	1,020.9	509.6	354.0	284.0	239.0	99.
Cumulative deficiency - gross	153.6	234.8	293.4	381.4	397.5	249.1	133.1	61.7	46.4	9.
% of reserves originally established - gross	8%	13%	17%	29%	52%	70%	46%	20%	16%	

Changes in Methodology During 2007

On December 18, 2007, the Company announced that it would report a reserve increase at its Lincoln General Insurance Company ("Lincoln General") subsidiary in the fourth quarter. The key reason for this change in estimate was a change in the methodology used in estimating future claim liabilities.

In recent periods, estimating the provision for unpaid claims for Lincoln General has been complicated by the fact that its own claims data was insufficiently stable, in the view of the independent actuary and management, to form a base for projecting ultimate loss ratios. This instability was largely the result of transitioning claims management for much of Lincoln General's program business from external service providers to in-house staff. Lincoln General grew rapidly during 2001 to 2003 and at the time outsourced many of the claims and underwriting functions to third party service providers. Over time it became apparent that tighter operational control of the claims functions should be gained and in-house claims capabilities built. At the end of 2002 approximately 65% of the claims on Lincoln's program business were handled by third parties, whereas today only 14% are externally handled. As the claims were brought in-house and the case reserves increased, this caused instability in the underlying claims data that actuaries use to predict future outcomes.

Consequently, in the past there has been a heavy reliance on industry loss development data in forecasting Lincoln's ultimate loss ratios. With the passage of time, the independent actuary determined in late November that Lincoln General's "own data" was now sufficiently stable that it should revise its actuarial models to primarily rely upon its "own data" and to markedly reduce the impact of industry data. This change in methodology is the primary reason for the increase in expected loss ratios and is expected to significantly reduce the volatility of estimates going forward. The development that Lincoln General has experienced is due to the fact that the underlying case reserves have developed differently than industry averages.

The two lines of business at Lincoln General that were substantially affected by this change in estimation are trucking and an artisan contractors liability program in California.

All of the Company's other operating insurance subsidiaries are utilizing their "own data" in their actuarial models. These assumptions have been consistently applied over a period of time and have demonstrated less volatility in the results of these companies.

Accident Year

Tables 12 and 13 on the next page assist in understanding the difference between calendar year and accident year losses. The financial statements are presented on a calendar year basis for all data. Claims payments and changes in reserves, however, may be made on accidents that occurred in prior years, not on business that is currently insured. Calendar year losses consist of payments and reserve changes that have been recorded in the financial statements during the applicable reporting period, without regard to the period in which the accident occurred. Calendar year results do not change after the end of the applicable reporting period, even as new claim information develops. Calendar year information is presented in Note 12(b) to the consolidated financial statements which shows the claims activity and impact on income for changes in estimates of unpaid claims. Accident year losses consist of payments and reserve changes that are assigned to the period in which the accident occurred. Accident year results will change over time as the estimates of losses change due to payments and reserve changes for all accidents that occurred during that period.

Table 12 is derived from the unpaid claims re-estimates included in Table 11 and summarizes the effect of re-estimates, net of reinsurance, on calendar year consolidated operations for the ten year period ended December 31, 2007. The first number in each row details the amount of reserve re-estimates included in the indicated calendar year and shows the accident year to which the re-estimates apply.

TABLE 12 Accident year versus calendar year losses
(In thousands of US dollars, except percentages)

By Accident Year	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998 & prior
By Calendar Year										
2007	(180,395)	332	85,685	54,484	26,325	9,491	(4,072)	902	1,771	5,477
2006		(64,329)	(93,877)	77,044	58,524	13,930	6,053	1,247		