The Westaim Corporation

Form 51-102F4

Business Acquisition Report

Item 1 Identity of company

1.1 *Name and address of company*

The Westaim Corporation (the "**Company**")
212 King Street West
Suite 201
Toronto ON M5H 1K5

1.2 *Executive officer*

For further information regarding this business acquisition report (the "**Report**"), please contact:

Jeffrey Sarfin
Chief Financial Officer
(416) 203-2253

Item 2 Details of acquisition

2.1 *Nature of business acquired*

On January 25, 2010, the Company agreed to purchase (the "**Acquisition**") all of the issued and outstanding shares of JEVCO Insurance Company ("**JEVCO**") from Kingsway Financial Services Inc. ("**KFS**") pursuant to the terms of a purchase agreement dated January 25, 2010, as subsequently amended (the "**Purchase Agreement**") and announced that it had arranged financing of $275 million for the purpose of completing the Acquisition.

JEVCO is a federal property and casualty insurance company existing under the *Insurance Companies Act* (Canada) (the "**ICA**") and authorized to carry on property, surety, automobile and liability insurance business in all of the provinces and territories of Canada. See "Information Concerning JEVCO".

2.2 *Date of acquisition*

The Acquisition was completed on March 29, 2010.

2.3 *Consideration*

On March 29, 2010, the Company completed the Acquisition pursuant to the terms of the Purchase Agreement. The aggregate purchase price payable by the Company to KFS in respect of the Acquisition was $261.3 million, subject to certain adjustments.

In order to finance the Acquisition, the Company had previously issued a total of 550 million subscription receipts (the "**Subscription Receipts**") at an issue price of $0.50 each for gross proceeds of $275 million. The gross proceeds from the sale of the Subscription Receipts, less certain expenses, were being held in escrow pending the satisfaction of certain conditions, including:

a) shareholders of the Company having approved the issuance of all of the securities issuable upon the conversion of the Subscription Receipts at a meeting of shareholders, held on March 25, 2010 ("**Shareholder Approval**");
b) the receipt of documents evidencing the required approval of the Acquisition under the *Insurance Companies Act* (Canada) ("**Regulatory Approval**"); and
c) all conditions required to complete the Acquisition (other than payment of the purchase price) having been satisfied or waived by the Company.

Shareholder Approval was obtained on March 25, 2010 and Regulatory Approval was obtained on March 29, 2010. Accordingly, the escrowed funds were released on March 29, 2010 to fund the purchase price in respect of the Acquisition and certain other expenses and all 550 million Subscription Receipts were automatically converted immediately prior to the completion of the Acquisition into an aggregate of 486,147,088 common shares of the Company and 63,852,912 Series 1 Class A non-voting, convertible participating preferred shares of the Company having the terms and conditions specified in the Articles of Amendment filed by the Company on February 26, 2010.

2.4 *Effect on financial position*

The effect of the Acquisition on the Company's financial position is outlined in the unaudited pro forma consolidated financial statements attached as Schedule "B" to the Report.

The Company does not presently plan or propose to make any material changes in its business or affairs, either generally or with respect to JEVCO's assets, that would reasonably be expected to have a significant effect on the results of operations or financial position of the Company, except as otherwise disclosed in its public filings on SEDAR at www.sedar.com.

2.5 *Prior valuations*

Not applicable.

2.6 *Parties to transaction*

Prior to the acquisition, JEVCO was not an informed person, associate or affiliate of the Company.

2.7 *Date of report*

June 11, 2010.

Item 3 Financial statements

The following financial statements and other information required by Part 8 of the National Instrument 51-102, Continuous Disclosure Objectives, are attached hereto and form part of this Report:

a) Audited financial statements and notes thereto of JEVCO as at and for the year ended December 31, 2009, together with the report of the auditors thereon, are attached hereto as Schedule "A" to this Report.
b) Unaudited financial statements and notes thereto of Kingsway General Insurance Company ("**KGIC**") as at and for the nine months ended September 30, 2009 and the nine months ended September 30, 2008 are attached hereto as Schedule "B" to this Report.
c) Audited financial statements and notes thereto of KGIC as at and for the year ended December 31, 2008 are attached hereto as Schedule "C" to this report.
d) Unaudited pro forma consolidated statement of operations of the Company, after giving effect to the Acquisition, for the year ended December 31, 2009 is attached hereto as Schedule "D" to this Report. This Report does not include a pro forma consolidated balance sheet as the Acquisition was accounted for in Westaim's unaudited consolidated interim financial statements for the three month period ended March 31, 2010, which has been filed on SEDAR and can be obtained at www.sedar.com.

The auditor of the financial statements of the acquired businesses has not provided its consent to the inclusion of its audit report in the business acquisition report.

Caution concerning forward-looking statements

This Report contains forward-looking statements within the meaning of securities laws. Forward-looking information is often, but not always, identified by the use of words, such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project", "may", "will", "should", "could", "estimate", "predict", or similar words suggesting future outcomes or language suggesting an outlook.

Forward-looking statements and information are based on current beliefs, as well as assumptions made by and information currently available to the Company concerning anticipated financial performance, business prospects, strategies and regulatory developments. Although management considers these assumptions to be reasonable, based on information currently available to it, they may prove to be incorrect.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution readers not to place undue reliance on these statements, as a number of important factors could cause the actual results to differ materially from the beliefs, plans, objectives, expectations and anticipations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to: the Company's expectations regarding possible adjustments to the purchase price for JEVCO; strategies, alternatives and objectives to maximize value for shareholders; expectations and assumptions relating to the Company's business plan; expectations regarding the management fees and other costs payable by the Company; the affect of adverse changes in equity markets or JEVCO's operations; JEVCO's ability to compete successfully in the insurance industry; expectations that JEVCO can continue to set its premiums at a level which produces an acceptable return compared to the risk assumed; JEVCO's ability to realize its investment objectives; the adequacy of JEVCO's provision for unpaid claims; JEVCO's ability to maintain its claims paying ratings; JEVCO's ability to obtain reinsurance with reliable carriers at acceptable rates; expectations regarding JEVCO's assets and liabilities; JEVCO's ability to retain key employees, customers and broker relationships; management's belief that its estimates for determining the valuation of the Company's assets and liabilities are appropriate; the Company's view that where remediation costs will be incurred many years into the future, third party recoveries cannot be estimated with certainty and that revisions to cost estimates and the recovery of actual remediation costs could result in material changes to the provision in future periods; that changes to interpretations of tax legislation could have a material effect on income tax provisions in future periods;

and the Company's determination that the adoption of new accounting standards will not have a material impact on its consolidated financial statements.

Further information regarding these and other risk factors affecting the Company may be found under the heading "Risks and Uncertainties" in our management's discussion and analysis for the year ended December 31, 2009 and under "Risk Factors" in our Annual Information Circular dated March 26, 2010 and our Information Circular dated February 26, 2010 and in our filings with the Canadian securities regulatory authorities, which may be found at www.sedar.com.

The foregoing list of factors that may affect future results is not exhaustive. When relying on our forward-looking statements to make decisions, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Furthermore, the forward-looking statements contained in this business acquisition report are made as of the date of this business acquisition report and the Company does not undertake any obligation to up-date publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. The forward-looking statements contained in this Report are expressly qualified by this cautionary statement.

Schedule "A"

Audited financial statements of
JEVCO Insurance Company

Financial Statements of

JEVCO INSURANCE COMPANY

Year ended December 31, 2009

AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Jevco Insurance Company as at December 31, 2009 and the statements of operations, changes in shareholder's equity, comprehensive income (loss), and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

/s/ KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

February 17, 2010

APPOINTED ACTUARY'S REPORT

To the Shareholder of
Jevco Insurance Company

I have valued the policy liabilities of Jevco Insurance Company for its balance sheet at December 31, 2009 and their change in the statement of operations for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities makes appropriate provision for all policyholders' obligations, and the financial statements fairly present the results of the valuation.

Pierre G. Laurin, FCIA, FCAS
Principal and Head of the Canadian P&C Practice

February 17, 2010

JEVCO INSURANCE COMPANY
Balance Sheet

As at December 31, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Assets		
Cash	$ 65,325	$ 26,025
Investments (notes 4 and 5)	895,590	280,703
Accrued investment income	6,275	2,405
Financed premiums	53,958	9,235
Claims recoverable from other insurers (note 9)	26,950	6,618
Accounts receivable and other assets	26,527	16,212
Income taxes recoverable	—	4,743
Due from related parties (note 12)	13,932	10,208
Due from reinsurers (notes 10 and 14)	46,911	93,642
Deferred policy acquisition costs	31,503	34,594
Future income taxes (note 13)	9,821	5,470
Capital assets (note 7)	52,666	25,365
Intangible assets (note 8)	1,361	—
	$1,230,819	$515,220
Liabilities		
Accounts payable and accrued liabilities	$ 10,193	$ 3,034
Income taxes payable	5,565	—
Due to related parties (note 12)	—	3,973
Unearned premiums	151,683	124,361
Unpaid claims (notes 10 and 14)	779,013	271,027
Unearned reinsurance commissions	38	8,299
	946,492	410,694
Shareholder's Equity		
Share capital (note 11)	29,390	29,390
Contributed surplus (note 11)	208,330	21,725
Retained earnings	47,023	58,262
Accumulated other comprehensive loss	(416)	(4,851)
	284,327	104,526
	$1,230,819	$515,220

Commitments and contingent liabilities (note 15)
See accompanying notes to financial statements.

On behalf of the Board:

/s/ Jean La Couture Director

/s/ Serge Lavoie Director

JEVCO INSURANCE COMPANY
Statement of Operations

Year ended December 31, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Premiums written:		
Direct	$184,982	$155,526
Assumed	14,328	116,862
	$199,310	$272,388
Net premiums written (note 10)	$171,767	$203,979
Revenue:		
Net premiums earned (notes 10 and 12)	$213,946	$203,920
Investment income	18,278	17,428
Net realized gain (loss) on sales of investments	4,355	(24,066)
	236,579	197,282
Expenses:		
Claims incurred (notes 10, 12 and 14)	175,340	143,886
Commissions and premium taxes (notes 10 and 12)	51,588	45,826
Management fees (note 12)	22,604	19,636
General and administrative expenses (recovery)	2,382	(251)
	251,914	209,097
Loss before income taxes	(15,335)	(11,815)
Income tax provision (recovery) (note 13):		
Current	32	(3,081)
Future	(4,128)	(1,021)
	(4,096)	(4,102)
Loss for the year	$ (11,239)	$ (7,713)

See accompanying notes to financial statements.

JEVCO INSURANCE COMPANY
Statement of Changes in Shareholder's Equity

Year ended December 31, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Share capital		
Balance at beginning of year	$ 29,390	$ 29,390
Issued during the year	—	—
Balance at end of year	29,390	29,390
Contributed surplus		
Balance at beginning of year	$ 21,725	$ 44,500
Contribution (withdrawal) during the year	186,605	(22,775)
Balance at end of year	208,330	21,725
Retained earnings		
Balance at beginning of year	$ 58,262	$ 65,975
Loss for the year	(11,239)	(7,713)
Balance at end of year	47,023	58,262
Accumulated other comprehensive loss		
Balance at beginning of year	$ (4,851)	$ (3,622)
Other comprehensive income (loss)	4,435	(1,229)
Balance at end of year	(416)	(4,851)
Total shareholder's equity at end of year	$284,327	$104,526

See accompanying notes to financial statements

JEVCO INSURANCE COMPANY
Statement of Comprehensive Income (Loss)

Year ended December 31, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Loss for the year	$(11,239)	$(7,713)
Other comprehensive income (loss), net of taxes:		
• Change in unrealized gains (losses) on available-for sale securities:		
Unrealized gains/(losses) arising during the year, net of income taxes(1)	2,534	(2,630)
Reclassification of net realized gains to net income, net of income taxes(2)	1,901	1,401
Other comprehensive income (loss)	4,435	(1,229)
Comprehensive loss	$ (6,804)	$(8,942)

(1) Net of income tax of $1,413 (2008 – $(1,155))

(2) Net of income tax of $579 (2008 – $715)

See accompanying notes to financial statements

JEVCO INSURANCE COMPANY
Statement of Cash Flows

Year ended December 31, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Cash provided by (used in):		
Operating activities:		
Loss for the year	$ (11,239)	$ (7,713)
Adjustments for:		
Net realized (gain) loss on sale of securities and assets	(4,355)	24,066
Future income taxes	(4,351)	(1,769)
Amortization of bond premiums (discounts)	1,913	(1,335)
Amortization of capital and intangible assets	1,708	999
	(16,324)	14,248
Changes in non-cash balances:		
Due from reinsurers	46,731	11,055
Deferred policy acquisition costs	3,091	2,505
Unearned premiums	27,322	(2,152)
Unpaid claims	507,986	(29,112)
Unearned reinsurance commissions	(8,261)	(728)
Net change in other non-cash balances	(71,461)	(25,762)
	489,084	(29,946)
Financing activities:		
Contributed (withdrawn) surplus	186,605	(22,775)
	186,605	(22,775)
Investing activities:		
Purchase of securities	(1,620,264)	(341,748)
Proceeds from sale of securities	1,014,703	424,839
Proceeds from sale of capital assets	15	6
Purchase of capital assets	(30,843)	(10,339)
	(636,389)	72,758
Increase in cash during the year	39,300	20,037
Cash, beginning of year	26,025	5,988
Cash, end of year	$ 65,325	$ 26,025
Supplementary disclosure of cash information:		
Cash received for:		
Interest	$ 24	$ 213
Income taxes	8,060	538

See accompanying notes to financial statements.

Jevco Insurance Company (the "Company") was incorporated under the Insurance Companies Act on April 10, 1980. The Company is licensed in all provinces and territories in Canada to write all classes of insurance, other than life. At December 31, 2009 the Company is a wholly-owned subsidiary of Kingsway Financial Services Inc. ("Kingsway Financial" or "Parent Company"), whose shares are listed on the Toronto and New York Stock Exchanges (refer to note 17).

1. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and also comply with the accounting requirements of the Office of the Superintendent of Financial Institutions Canada ("OSFI").

(a) Changes in accounting policies:

(i) Current year changes:

On January 1, 2009, the Company adopted amendments to CICA HB Section 3862, Financial Instruments – Disclosures. These amendments include additional disclosure requirements for the fair value of financial instruments and enhanced liquidity risk disclosure. The Company also adopted further amendments to Section 3862 which requires all financial instruments to be disclosed within these levels that prioritize the quality and reliability of the information used in estimating the fair value of these instruments. The fair values for the three levels are based on:

Level 1 – quoted prices in active markets

Level 2 – models using observable inputs other than market prices

Level 3 – models using inputs that are not based on observable market data.

See note 5 for further details.

During 2009 the Company adopted CICA's new accounting standard, Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. The new standard establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The new standard also provides guidance for the recognition of internally developed intangible assets, including assets developed from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally generated. See note 8 for further details.

(ii) Future changes:

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that a profit-oriented publicly accountable enterprise will be required to adopt IFRS. IFRS will replace current Canadian GAAP for those enterprises. For the Company, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. The Company has established a changeover plan in order to transition its financial statement reporting, presentation and disclosure under IFRS to meet the January 1, 2011 deadline. The impact of IFRS on the financial statements at the time of transition and on implementation is being assessed.

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

(b) Investments:

Consistent with the guidance in CICA Handbook Section 3855 the Company has classified the securities held in its investment portfolio as available for sale. During the year, the Company concluded that it had both the intent and ability to hold a portion of the Company's fixed income investments to maturity and accordingly reclassified a portion of its investment portfolio to the held-to maturity category. See note 4 for further details.

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

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

Dividends and interest income from these securities are included in "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 settlement date accounting. Transaction costs are capitalized and, when applicable, amortized over the expected life of the instrument using the effective interest rate method.

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

(c) Deferred policy acquisition costs:

The Company defers brokers' commissions, premium taxes and other underwriting and marketing costs 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 2009. Anticipated investment income is included in determining the realizable value of the deferred policy acquisition costs.

(d) Capital assets:

Capital assets are reported in the financial statements at amortized cost. Amortization of capital assets has been provided by the straight-line method over the estimated useful lives of such assets. The useful lives are 30 years for the buildings, 5 years for the leasehold improvements, 5 to 7 years for furniture and equipment, 3 to 5 years for computers, and 3 to 5 years for automobiles.

(e) Intangible assets:

Intangible assets are comprised of software purchased and internally developed software. Amortization of the intangible assets has been provided by the straight-line method over the estimated useful lives, which are 3 to 5 years.

(f) Premium revenue and unearned premiums:

The Company earns motorcycle premiums over the period of risk covered by the policy based on the Company's experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract. Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the year-end. A premium deficiency is established if the unearned premiums are less than the estimated future claims and expenses to be incurred less investment income to be earned during the period premiums are earned.

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.

In Canada, automobile insurance premium rates other than for fleet automobile are regulated by the provincial 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. Accordingly, a significant portion of the Company's revenue is subject to regulatory approvals.

(g) Unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate of 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 takes into consideration the time value of money using discount rates based on projected investment income from the assets supporting the provisions and includes an explicit provision for adverse deviation. Expected reinsurance recoveries on unpaid claims are recognized as amounts recoverable at the same time using principles consistent with the Company's method for establishing the related liability.

(g) Unpaid claims:

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 claim 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.

(h) Claims recoverable from other insurers:

The expected recoveries from other insurers on claims are recognized as amounts receivable at the same time as the related liability, using principles consistent with the Company's method for establishing the related liability.

These estimates are subject to uncertainty. The resulting changes in estimates of the ultimate recoveries are recorded as incurred.

(i) Reinsurance ceded:

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 related estimated amounts payable to policyholders. Unearned premiums and deferred policy acquisition costs are also reported before reduction for business ceded to reinsurers and the reinsurer's portion is classified with amounts due from reinsurers and unearned reinsurance commissions, respectively.

Amounts recoverable from reinsurers are estimated in a manner consistent with liabilities associated with the reinsured policy.

(j) 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. Key areas where management has made difficult, complex or subjective judgments, often as a result of matters inherently uncertain include income taxes, unpaid claims and investment impairment. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

2. Role of the actuary and 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. With respect to the preparation of these financial statements, the independent actuary, Towers Watson carries out a review of management's valuation of the unpaid claim liabilities and provides an opinion to the Board of Directors and the shareholders regarding the appropriateness of the 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. The independent actuary is responsible for assessing whether the assumptions and methods used for the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In performing the review of these 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, taking into consideration the circumstances of the Company and the nature of the insurance policies.

(Tabular amounts in thousands of dollars)

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 appointed actuary's report outlines the scope of the review and the opinion.

Role of the auditors

The external auditors have been appointed by the shareholder, pursuant to the Insurance Companies Act of Canada. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and to report thereon to the shareholders. In carrying out their audit, the auditors make use of the work of the actuary and his report on the policy liabilities of the Company. The auditors' report to the shareholder outlines the scope of their audit and their opinion.

3. Reinsurance transactions with related parties:

Effective October 1, 2009 the Company commuted its reinsurance treaties with commonly controlled entities. The effect of the commutation on the Company is shown below:

Assets:	
Decrease in cash and investments	$133,816
Decrease in recoverable from reinsurers	90,983
Decrease in deferred policy acquisition costs	11,153
Decrease in due from related parties	4,472
	$240,424
Liabilities and Shareholder's Equity:	
Decrease in unearned reinsurance commissions	$ 7,246
Decrease in unpaid claims	192,508
Decrease in deferred policy acquisition costs	37,177
Decrease in Shareholder's Equity	3,493
	$240,424

(Tabular amounts in thousands of dollars)

The decrease in the Shareholder's Equity relates to a risk premium on the commutation of $4,721,000 paid by the Company to a commonly controlled entity and $1,228,000 received by the Company from a commonly controlled entity which is included in the net loss for the year.

Effective October 1, 2009 but subsequent to the commutation of the reinsurance treaties as described above, the Company entered into an Assumption Reinsurance agreement whereby the Company assumed all the policy liabilities and supporting assets of the commonly controlled entity. The effect of the Assumption Reinsurance agreement on the Company is shown below:

Assets:	
Increase in cash and investments	$620,876
Increase in recoverable from reinsurers[1]	50,111
Increase in claim recoverable[1]	22,875
Increase in capital assets	30,610
Increase in accounts receivable and other assets	59,622
Increase in deferred policy acquisition costs	14,749
	$798,843
Liabilities and Shareholder's Equity:	
Increase in unpaid claims[1]	$707,047
Increase of unearned premium	96,796
Decrease in Shareholder's Equity	(5,000)
	$798,843

[1] Net unpaid claims of $634,061 transferred through the assumption agreement (note 14)

The decrease in Shareholder's Equity relates to a commission on the assumption reinsurance agreement of $5,000,000 paid by the Company to a related party which is included in the net loss for the year.

4. Investments:

Summary:

	2009	2008
Available-for-sale investments carried at fair value	$797,655	$280,703
Held-to-maturity investments carried at amortized cost	97,935	—
	$895,590	$280,703

(Tabular amounts in thousands of dollars)

The table below provides details of the amortized cost and fair value of available-for-sale investments:

		December 31, 2009			
		Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Term deposits:		$ 12,463	$ 2	$ —	$ 12,465
Bonds:					
Canadian	– Government	219,284	92	2,306	217,070
	– Corporate	454,280	5,799	1,934	458,145
	– Mortgage backed	5,527	3	61	5,469
	– Other asset backed	27,563	61	149	27,475
U.S.	– Corporate	52,801	393	178	53,016
Other	– Corporate	16,397	—	72	16,325
Sub-total		788,315	6,350	4,700	789,965
Common Shares	– Canadian	1,026	869	—	1,895
	– U.S	—	—	—	—
Preferred shares	– Canadian	8,000	—	2,205	5,795
		$797,341	$7,219	$6,905	$797,655

		December 31, 2008			
		Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Term deposits:		$ 34,750	$ 124	$ 15	$ 34,859
Bonds:					
Canadian	– Government	58,918	3,742	8	62,652
	– Corporate	85,128	758	4,106	81,780
	– Mortgage backed	36,507	9	3,085	33,431
	– Other asset backed	—	—	—	—
U.S.	– Corporate	15,407	4	1,807	13,604
Other	– Corporate	4,860	200	134	4,926
Sub-total		235,570	4,837	9,155	231,252
Common Shares	– Canadian	43,855	1,646	—	45,501
	– U.S	170	81	—	251
Preferred shares	– Canadian	8,086	—	4,387	3,699
		$286,681	$6,564	$13,542	$280,703

During the year a portion of available-for-sale investments was transferred from the available-for-sale category to the held-to-maturity category as the Company concluded that it had both the intent and ability to hold these investments to maturity. Accordingly, the Company transferred fixed income investments, with an estimated fair value of approximately $98,100,000 at the date of transfer, from the available-for-sale category to the held-to-maturity category.

(Tabular amounts in thousands of dollars)

The following table shows the amortized cost, gross unrecognized gains and losses, as well as the fair value of the Company's held-to-maturity investments portfolio as at December 31 2009. The amortized cost at December 31, 2009 includes approximately $900,000 of unrealized gains as a result of a transfer of investments from the available-for-sale to the held-to-maturity category during the year. These unrealized gains continue to be reported as a component of accumulated other comprehensive income in the accompanying Balance Sheet, and are being amortized over the remaining life of the securities through comprehensive income.

	December 31, 2009			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Bonds:				
Canadian – Government	$74,057	$ 8	$102	$73,963
– Corporate	23,878	301	—	24,179
Sub-total	$97,935	$309	$102	$98,142

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

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:

- Assessing the Company's intent to sell those investments;
- Assessing whether it is more likely than not that the Company will be required to sell those investments before the recovery of its amortized cost basis;
- Assessing if any credit losses are expected for those investments. The assessment includes considering of, among other things, all available information and factors having a bearing upon collectability of security such as changes to credit rating by rating agencies, financial condition of the issuer, expected cash flows and value of any underlying collateral;
- 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 investment;
- Obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;
- Reviewing the trading range of certain investments over the preceding calendar period;
- Assessing if declines in market value are other than temporary for debt investment 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 investment holdings 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 investments 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 investments may not reflect future debt service capabilities and may not reflect the company's unknown underlying financial problems.

As a result of the above analysis performed by management to determine declines in market value that are other than temporary, write downs for other-than-temporary impairments were $1,400,000 (2008—$19,700,000) and the entire amount of other-than-temporary impairments has been recognized in earnings as a component of net realized gain (loss) of investment income.

Management has reviewed currently available information regarding other investments whose estimated fair values are less than their carrying amounts and believes that these unrealized losses are not other than temporary and are primarily due to temporary market and sector related factors rather than to issuer-specific factors. The company does not intend to sell those investments and it is not more likely than not that it will be required to sell those securities before recovery of its amortized cost.

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 holding financial instruments include credit risk, market risk, liquidity risk and cash flow risk. These risks may be caused by factors specific to an individual instrument or factors affecting all instruments traded in the market. The Company has a comprehensive risk management framework to monitor, evaluate and manage the risks assumed in conducting its business.

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

Credit risk:

The Company is exposed to credit risk principally through its investments and balances receivable from policyholders and reinsurers. The Company monitors concentration and credit quality risk through policies to limit and monitor its exposure to individual issuers or related groups (with the exception of Canadian government bonds) as well as through ongoing review of the credit ratings of issuers held in the securities portfolio. The Company's credit exposure to any one individual policyholder is not material. The Company's policies, however, are distributed by agents, program managers and 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's insolvency.

(Tabular amounts in thousands of dollars)

The table below summarizes the credit exposure of the Company from its investments in fixed income securities and term deposits by rating.

Available-for-sale (measured at fair value)

	2009		2008	
AAA/Aaa	$175,291	22.2%	$110,548	47.8%
AA/Aa2	175,487	22.2%	28,695	12.4%
A/A2	331,146	41.9%	69,823	30.2%
BBB/Baa2	102,586	13.0%	14,600	6.3%
BB/Ba2	4,283	0.6%	2,969	1.3%
B/B2	—	0.0%	1,482	0.6%
CCC/Caa or lower, or non rated	1,172	0.1%	3,135	1.4%
Total available-for-sale	$789,965	100.0%	$231,252	100.0%

Held-to-maturity (measured at amortized cost)

	2009		2008	
AAA/Aaa	$18,964	19.4%	$—	$—
AA/Aa2	65,738	67.1%	—	—
A/A2	13,233	13.5%	—	—
Total held-to-maturity	$97,935	100.0%	$—	$—

At December 31, 2009, 86.3% (2008 – 90.4%) of the available-for-sale fixed income portfolio and 100.0% (2008 not applicable) of held-to-maturity fixed income portfolio is rated “A” or better. Changes in this balance period over period are primarily due to the credit profile of the securities portfolio assumed through reinsurance commutation and on assumption reinsurance agreement.

The table below summarizes the credit exposure of the Company for amounts receivable from reinsurers, by the rating, as assigned by A.M. Best to the applicable reinsurers.

	2009		2008	
A++	$ 3,289	7.1%	$ 163	0.2%
A+	6,409	13.6%	1,215	1.3%
A	36,928	78.7%	1.221	1.3%
B++	85	0.2%	90,736	96.9%
Not Rated	200	0.4%	307	0.3%
Total	$46,911	100.0%	$93,642	100.0%

Market risk:

The market risk exposure of the Company is, primarily, to the changes in interest rates and equity prices. Market risk is subject to risk management. The Investment Committee of the Board of the parent company and senior management of the Company monitor the Company’s market risk exposures and activities that give rise to these exposures.

Interest rate risk:

The Company's primary market risk exposure is changes in interest rates. Because substantially all of the investments are comprised of fixed income securities, periodic changes in interest levels generally impact the financial results to the extent that reinvestment yields are different than the original yields on maturing securities. Also, during periods of rising interest rates, the market value of the existing fixed income securities will generally decrease and realized gains on fixed income securities will likely be reduced. The reverse is true during periods of declining interest rates.

Duration is a measure used to estimate the extent market values of fixed income instruments change with changes in interest rates. Using this measure, it is estimated that:

(i) An immediate hypothetical 100 basis point or 1 percent parallel increase in interest rates would decrease the market value of the available-for-sale fixed income securities by $40,100,000 (2008 – $8,700,000), representing 5.1% (2008 – 3.8%) of the $790,000,000 (2008 – $231,300,000) fair value of available-for-sale fixed income securities portfolio.

(ii) An immediate hypothetical 100 basis point or 1 percent parallel decrease in interest rates would increase the market value of the unpaid claims liabilities by $15,400,000 (2008 – $4,100,000), representing 2.2% (2008 – 1.5%) of the $706,400,000 (2008 – $199,300,000) of net unpaid claims liabilities carried on the balance sheet.

During 2009, the Company purchased U.S. dollar denominated provincial bonds with a market value of $76,200,000 as at December 31 2009. The Company is exposed to changes in the Canadian dollar value of its U.S. dollar denominated securities to the extent that the Canadian to U.S. dollar exchange rate changes. An increase in the value of the U.S. dollar relative to the Canadian dollar increases the market value of these holdings. A 1 cent increase in the value of the U.S. dollar increases the market value of these holdings by $800,000. The reverse is true during periods of a weakening U.S dollar.

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

- The securities in the Company's portfolio are not impaired;
- Credit and liquidity risks have not been considered;
- Interest rates and equity prices move independently; and
- Shifts in the yield curve are parallel.

In addition, it is important to note that available-for-sale securities in an unrealized loss position as reflected in Other Comprehensive Income, may at some point in the future be realized through a sale or right down to recognize an other-than-temporary impairment.

Equity prices risk:

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

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

Equity price risk is mitigated through diversification. The equity portfolio is managed through the use of services of third party professional investment management firms and their performance is actively monitored by management and the Investment Committee of the Board of Directors. In early 2009, the Company elected to significantly reduce this equity price risk by divesting off substantially all the equity securities portfolio.

At December 31, 2009, management estimates that a 10% increase in prices of equity securities held as available-for-sale, with all other variable held constantly, would increase Other Comprehensive Income and Comprehensive Income before tax by $800,000 (2008 – $4,900,000). A 10% decrease in equity prices would have the corresponding opposite effect on Other Comprehensive Income and Comprehensive Income. Equities comprise 1.0% (2008 – 17.6%) of the Company's available-for-sale investments portfolio at December 31, 2009.

Liquidity risk and cash flow risk:

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

(Tabular amounts in thousands of dollars)

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, 2009	**One year or less**	**One to five years**	**Five to ten years**	**More than ten years**	**No Specific Date**	**Total**
Assets:						
Cash & cash equivalents	65,325	—	—	—	—	65,325
Securities (Available for sale)	23,219	370,709	384,364	11,673	7,690	797,655
Securities (Held to maturity)	—	—	97,935	—	—	97,935
Accrued investment income	6,275	—	—	—	—	6,275
Finance premiums	53,958	—	—	—	—	53,958
Claims recoverable	8,616	15,399	2,730	205	—	26,950
Accounts receivable & other assets	26,527	—	—	—	—	26,527
Due from related parties	13,932	—	—	—	—	13.932
Due from reinsurers	14,997	26,805	4,752	357	—	46,911
Total:	**212,849**	**412,913**	**489,781**	**12,235**	**7,690**	**1,134,468**
Liabilities:						
Accounts payable & accrued liabilities	10,193	—	—	—	—	10,193
Unpaid claims	249,050	445,128	78,914	5,921	—	779,013
Total:	**259,243**	**445,128**	**78,914**	**5,921**	**—**	**789,206**

(Tabular amounts in thousands of dollars)

The Company's investment portfolio is liquid, providing sufficient flexibility to generate cash to meet short term operational needs that are not met through cash flows from operations.

As at December 31, 2008	One year or less	One to five years	Five to ten years	More than ten years	No Specific Date	Total
Assets:						
Cash & cash equivalents	26,025	—	—	—	—	26,025
Securities (Available for sale)	55,895	82,355	81,011	11,991	49,451	280,703
Securities (Held to maturity)	—	—	—	—	—	—
Accrued investment income	2,405	—	—	—	—	2,405
Finance premiums	9,235	—	—	—	—	9,235
Claims recoverable	2,308	3,476	741	93	—	6,618
Accounts receivable & other assets	16,212	—	—	—	—	16,212
Due from related parties	10,208	—	—	—	—	10,208
Due from reinsurers	32,662	49,190	10,479	1,311	—	93,642
Total:	**154,950**	**135,021**	**92,231**	**13,995**	**49,451**	**445,048**
Liabilities:						
Accounts payable & accrued liabilities	3,034	—	—	—	—	3,034
Due to related parties	3,973	—	—	—	—	3,973
Unpaid claims	94,534	142,370	30,328	3,795	—	271,027
Total:	**101,541**	**142,370**	**30,328**	**3,795**	**—**	**278,034**

The coupon rates for the fixed term investments range from 2.1% to 11.9% at December 31, 2009 (4.0% to 15.0% at December 31, 2008). The average effective yield (using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts) is 3.8% (2008 – 4.5%).

(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. 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.

(Tabular amounts in thousands of dollars)

Refer to Note 4 with respect to fair value disclosure on investments. The Company uses fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value. The extent of the Company's use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information (Level 3) in the valuation of investments as at December 31, 2009 was as follows:

Description		December 31, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available for sale investments:					
Term deposits:		$ 12,465	$ —	$ 12,465	$—
Fixed income investments:					
Canadian	– Government	217,070	—	217,070	—
	– Corporate	458,145	—	458,145	—
	– Commercial mortgage backed	5,469	—	5,469	—
	– Other asset backed	27,475	—	27,475	—
U.S.	– Corporate	53,016	—	53,016	—
Other	– Corporate	16,325	—	16,325	—
Equity Investments:					
Canadian		1,895	1,895	—	—
Preferred Investments:				—	—
Canadian		5,795	5,795		
		$797,655	$7,690	$789,965	$—
Held to Maturity investments:					
Fixed income investments:					
Canadian	– Government	73,963	—	73,963	—
	– Corporate	24,179	—	24,179	—
Total		$895,797	$7,690	$888,107	$—

The provision for policy liabilities is based on the present value of future cash flows plus provisions for adverse development and is considered to be an indicator of fair value as there is no ready market for the trading of insurance policy liabilities.

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

(Tabular amounts in thousands of dollars)

6. Capital Management:

Objectives, policies & procedures:

The Company has three capital management objectives: Meet regulatory requirements, maintain strong credit rating and maximize returns to the shareholder. Towards achievement of these objectives, the Company employs a strong and efficient capital base and it manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength, capital mix, dividends and return on capital. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis. Management develops the capital strategy and oversees the capital management processes of the Company. Capital is managed using both regulatory capital measures and internal metrics. The Company's capital is primarily derived from common shares, contributed surplus and retained earnings.

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

Regulatory capital requirements & ratios:

The Company is regulated by the Office of the Superintendent of Financial Institutions (OSFI) and is required to maintain a level of capital sufficient to support the volume and risk profile of the Company's business. Generally, OSFI requires insurers to achieve a ratio of at least 150% of a minimum capital test (MCT) formula. As at December 31, 2009 the MCT ratio of the Company is 229% (2008 – 190%).

7. Capital Assets:

	2009		
	Cost	Accumulated amortization	Net book value
Land	$ 5,008	$ —	$ 5,008
Buildings	49,915	5,012	44,903
Furniture and equipment	3,253	1,308	1,945
Computers	1,155	363	792
Automobiles	42	24	18
	$59,373	$6,707	$52,666

	2008		
	Cost	Accumulated amortization	Net book value
Land	$ 1,252	$ —	$ 1,252
Buildings	25,774	2,854	22,920
Furniture and equipment	1,765	723	1,042
Computers	396	268	128
Automobiles	55	32	23
	$29,242	$3,877	$25,365

(Tabular amounts in thousands of dollars)

Amortization expense of capital assets during the year-ended December 31, 2009 was $1,708 (2008 – $999). The Company recognized a loss of $471 (2008 – $nil) on the portion of the building it owned in the joint venture (note 16) prior to the October 1, 2009 assumption reinsurance agreement (note 3) based on the fair value of the building.

8. Intangible Assets:

	2009		
	Cost	**Accumulated amortization**	**Net book value**
Software development	$1,857	$495	$1,361
	$1,857	$495	$1,361

The intangible assets related to software development were reclassified from capital assets to intangible assets effective January 1, 2009, in accordance with the requirements of the CICA Handbook Section 3064.

9. Claims recoverable from other insurers:

In accordance with the Insurance Act of Ontario (the "Act"), the Company has a right of indemnification for certain benefits paid to its own insured from the insurer of a third party at fault. The Act also provides for an arbitration process when the two insurers are not in agreement as to the amount of losses to be transferred.

Failure of other insurers to honor their obligations could result in losses to the Company.

10. Underwriting policy and reinsurance ceded:

In the normal course of business, the Company seeks to reduce the loss that may arise from a catastrophe or other events that cause unfavorable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers.

Failure of reinsurers to honor their obligations could result in losses to the Company.

Underwriting risk:

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

The Company's underwriting objective is to develop business within its target market on a prudent and diversified basis and to achieve profitable underwriting results.

Pricing risk:

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

(Tabular amounts in thousands of dollars)

Reinsurance risk:

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

The due from reinsurers is detailed as follows:

	2009	2008
Unearned premiums	$ 1,193	$28,488
Unpaid claims and adjustment expenses	45,718	65,154
	$46,911	$93,642

	2009	2008
Related reinsurers	$ —	$90,626
Unrelated reinsurers	46,911	3,016
	$46,911	$93,642

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss.

Until October 1, 2009 when the related party reinsurance treaties were commuted the Company entered into reinsurance arrangements with related companies which are commonly controlled, whereby the Company assumed 40% of related companies' net premiums and ceded 22.5% of its net premiums to a related company. Each of these arrangements limits the maximum amount on any one loss to $750,000 in the event of a liability claim, and $375,000 in the event of a property claim.

(Tabular amounts in thousands of dollars)

In addition, the Company has obtained catastrophe reinsurance, which together with related companies, provides coverage in the event of a series of claims arising out of a single occurrence, which limited this exposure to $1,500,000 (2008 – $1,500,000) per occurrence for the Canadian subsidiaries of the parent to a maximum of $125,000,000 (2008 – $125,000,000). After October 1 2009, the exposure per occurrence increased from $1,500,000 to $2,500,000 and is subject to a maximum of $125,000,000.

The effect of reinsurance transactions on items disclosed in the statement of operations are as follows:

	2009	2008
Net premiums earned:		
Assumed – Related	$66,489	$147,393
Ceded – Related	45,194	66,923
Ceded – Other	9,643	3,698
Claims incurred:		
Assumed – Related	59,645	108,218
Ceded – Related	28,923	41,400
Ceded – Other	(4,299)	(1,157)
Commissions and premium taxes:		
Assumed – Related	16,395	36,239
Ceded – Related	10,282	18,082
Ceded – Other	73	36

11. Share capital and contributed surplus:

Share capital consists of the following:

	2009	2008
Authorized:		
Unlimited number of common shares, without nominal or par value		
Issued:		
194,257 common shares	$29,390	$29,390

In order to support the capital requirements related to the commutation and assumption reinsurance agreement that took place on October 1, 2009 (note 3), the parent company injected $186,605,000 in cash which was accounted for as contributed surplus.

(Tabular amounts in thousands of dollars)

12. Related party transactions:

In the normal course of business, the Company enters into reinsurance transactions on commercial terms with related parties. Effective October 1, 2009 the Company entered into commutation and assumption reinsurance agreements with these commonly controlled entities as described in note 3. Details of the impact of these transactions on the financial statements are provided in note 11. In addition, the Company had the following transactions with the parent company:

	2009	2008
Management fees paid to Kingsway Financial	$32,319	$25,891
Less management fees relating to internal loss adjustment expenses charged to claims incurred	(9,130)	(5,649)
Less management fees relating to investment management expenses charged to investment income	(585)	(606)
	$22,604	$19,636

The Company has a management agreement with its parent company, whereby the Company pays a management fee of 115% of the direct costs and expenses incurred or paid by the parent in the provision of goods and services, facilities, supplies, equipment, premises and repairs in accordance with the said agreement.

During 2009, the Company paid $102,762 (2008 – $11,769) for adjusting fees to a commonly controlled company and received $nil (2008 – $353,547) for leasing arrangements from a controlled company.

Amounts due from (to) related parties are summarized as follows:

	2009	2008
Due from (to) the parent company	$ 787	$(2,807)
Due from an affiliated companied	13,145	9,042
	$13,932	$ 6,235

All related party balances are non-interest bearing and are payable monthly in arrears.

(Tabular amounts in thousands of dollars)

13. Income taxes payable (recoverable):

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

	2009	2008
Income before income taxes	$(15,335)	$(11,815)
Statutory tax rate	31.60%	34.60%
Provision based on statutory rate	(4,846)	(4,088)
Non-taxable investment income	(106)	(395)
Impact of changes in future tax rates	1,056	242
Other	(200)	139
Income tax recovery	$ (4,096)	$ (4,102)

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

	2009	2008
Future income tax asset (liability):		
Unpaid claims	$10,413	$3,131
Investments	(240)	2,151
Other	(352)	188
Net future income tax asset	$ 9,821	$5,470

14. Unpaid claims and claims incurred:

(a) Nature of unpaid claims:

The establishment of the provision for unpaid claims and adjustment expenses 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, investment rates of return, 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-tailed claims, such as general liability and automobile accident benefit claims.

(Tabular amounts in thousands of dollars)

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

Reserving risk arises due to the length of time between the occurrences of a loss, the reporting of the loss to the insurer and ultimate resolution of the claim. Claim provisions are expectations of the ultimate cost of resolution and administration of claims based on an assessment of facts and circumstances then known, a review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

Variables in the reserve estimation process can be affected by receipt of additional claim information and other internal and external factors, such as changes in claims handling procedures, economic inflation, legal and judicial trends, legislative changes, inclusion of exposures not contemplated at the time of policy inception and significant changes in severity or frequency of claims relative to historical trends. Due to the amount of time between the occurrence of a loss, the actual reporting of the loss and the ultimate payment, provisions may ultimately develop differently from the actuarial assumptions made when initially estimating the provision for claims. The Company's provision for claims are reviewed separately by, and must be acceptable to internal actuaries at the Company, the independent appointed actuary, and an external valuation actuary.

(b) Provision for unpaid claims and adjustment expenses:

The provision for unpaid claims and adjustment expenses is discounted using a rate based on the Company's projected investment income from the assets supporting the provisions, and reflecting the estimated timing of payments and recoveries. The discount rate used is 4.10% (2008—5.24%). Reinsurance recoverable estimates are discounted based on a rate using the Company's investment portfolio yield.

Margins for adverse development are included in the provision for unpaid claims and adjustment expenses and in the reinsurance recoverable estimates to allow for possible deterioration of experience relating to asset default, reinvestment risk, claims development and recoverability of reinsurance balances.

The gross provision and reinsurance recoverable estimates are as follows:

	2009		2008	
	Undiscounted	**Discounted**	**Undiscounted**	**Discounted**
Gross provision	$763,738	$779,013	$273,014	$271,027
Reinsurance ceded	(74,178)	(72,668)	(73,180)	(71,772)

The Company has a concentration of business in motorcycle insurance in the provinces of Quebec, Alberta and Ontario.

(Tabular amounts in thousands of dollars)

An evaluation of the adequacy of policy liabilities is completed at the end of each financial year. This evaluation 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 provisions for unpaid claims for the years ended December 31, were as follows:

	2009	2008
Unpaid claims, beginning of year:		
Gross	$ 271,027	$ 300,139
Reinsurance ceded	(71,772)	(79,764)
Unpaid claims, beginning of year, net	199,255	220,375
Unpaid claims under an assumption reinsurance agreement (note 3)	634,061	—
Provision for claims occurring:		
In the current year	175,043	145,396
In prior years	297	(1,510)
Claims paid during the year	(302,311)	(165,006)
Unpaid claims, end of year, net	706,345	199,255
Reinsurers' share of unpaid claims	45,718	65,154
Other insurers' share of unpaid claims (note 9)	26,950	6,618
Provision for unpaid claims, end of year	$ 779,013	$ 271,027

The provision for unpaid claims by major lines of business is as follows:

	2009	2008
Personal lines	$691,374	$234,255
Commercial lines	87,639	36,772
Provision for unpaid claims – end of year	$779,013	$271,027

The Company's direct written premiums are derived from the following business lines:

	2009	2008
Personal Lines	80%	84%
Commercial Lines	20%	16%
Total Direct Premiums Written	100%	100%

15. Commitments and contingent liabilities:

(a) In connection with its operations, the Company is from time to time named as defendant 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 expenses 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.

(Tabular amounts in thousands of dollars)

(b) The Company has purchased a number of annuities in settlement of claims. These annuities have been purchased from registered Canadian life insurers with high claims paying ability ratings as determined by outside rating organizations. The total value of the annuities purchased by the Company at December 31, 2009 is $41,850,000 (2008 – $6,250,000). The Company has a contingent credit risk with respect to the failure of these life insurers which management has assessed as being immaterial. The Company has assessed the fair value of these financial guarantees to be nil based on the claim paying ability of the life insurers and historical experience.

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

2010	$264
2011	$261
2012	$186
2013	$199
2014	$199
Thereafter	$150

(d) The Company pledges assets to third parties to collateralize liabilities incurred under its policies of insurance or for the services provided by them to the company. At December 31, 2009, the amount of such pledged assets was $5,000,000 (2008 – $5,000,000). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company's standard risk management controls.

16. Joint venture:

The Company acquired, on October 1, 2008, a 25% ownership in a real estate joint venture with a related party which is commonly controlled. The transaction was accounted for as a joint venture until October 1, 2009 when the Company acquired the remaining 75% ownership in the joint venture (note 3). The following amounts represent the Company's interest:

	2009	2008
Current assets	$ 4,398	$ 642
Capital assets	37,148	9,888
Current liabilities	118	7
Investment Income	—	1
Cash inflows (outflows) resulting from operating activities	3,928	(587)
Cash inflows (outflows) resulting from investing activities	(36)	321

The capital assets include land of $5,008,000, building of $31,177,000 and furniture and equipment of $963,000.

17. Subsequent events:

On January 25, 2010 the Company's parent entered into a "purchase and sale" agreement with The Westaim Corporation ("Westaim") whereby Westaim will acquire 100% of the ownership interests in Jevco. The finalization of the transaction is subject to completion of the terms of the purchase and sale agreement including regulatory approval and is expected to close in March 2010.

18. Comparative figures:

Certain prior year's comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

Schedule "B"

Unaudited financial statements of
Kingsway General Insurance Company

Financial Statements of

KINGSWAY GENERAL INSURANCE COMPANY

Nine months ended September 30, 2009

KINGSWAY GENERAL INSURANCE COMPANY
Balance Sheet
Unaudited

As at September 30, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Assets		
Cash	$ 29,568	$ 17,550
Securities (notes 5 and 6)	183,015	180,789
Accrued investment income	1,899	1,839
Financed premiums	49,896	46,321
Accounts receivable and other assets	14,286	45,050
Claims recoverable (note 8)	22,875	31,098
Income taxes recoverable	10,749	18,855
Future income taxes (note 13)	4,994	5,202
Due from related parties (note 12)	17,883	32,913
Recoverable from reinsurers (notes 11 and 14)	531,564	575,217
Deferred policy acquisition costs	14,748	22,545
Capital assets (note 9)	30,950	32,818
	$912,427	$1,010,197
Liabilities and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 4,903	$ 5,165
Due to related parties (note 12)	—	3,418
Unearned premiums (note 11)	96,796	137,870
Unpaid claims (notes 11 and 14)	707,047	737,343
Unearned reinsurance commissions	18,124	25,986
	826,870	909,782
Shareholders' equity:		
Share capital (note 10)	20,204	20,204
Contributed surplus	56,254	49,254
Retained earnings	6,395	39,729
Accumulated other comprehensive income (loss)	2,704	(8,772)
	85,557	100,415
	$912,427	$1,010,197

Commitments and contingent liabilities (note 16)
See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Operations
Unaudited

As at September 30, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Direct premiums written	$159,622	$245,773
Net premiums written	$ 47,660	$ 78,303
Revenue:		
Net premiums earned (notes 11 and 12)	$ 61,262	$ 83,919
Investment income	2,643	6,845
Net realized gain (loss) on sales of securities	(841)	606
Premium finance income	4,199	3,546
Gain on sale of capital assets	—	—
	67,345	103,104
Expenses:		
Claims incurred (notes 11, 12 and 14)	60,592	76,695
Commissions and premium taxes (notes 11 and 12)	43	4,208
Management fees (note 12)	22,300	30,663
General and administrative expenses (note 12)	6,344	7,933
	89,279	119,499
Loss before income taxes	(22,016)	(24,583)
Income taxes (recovery) (note 13):		
Current	(8,672)	(7,899)
Future	893	(534)
	(7,779)	(8,433)
Net loss	$ (14,237)	$ (16,150)

See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Changes in Shareholder's Equity
Unaudited

Nine months ended September 30, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Share capital		
Balance at beginning of year	$ 20,204	$ 20,204
Issued during the period	—	—
Balance at end of period	20,204	20,204
Contributed surplus		
Balance at beginning of year	$ 49,254	$ 49,254
Contributions during the period	7,000	—
Balance at end of period	56,254	49,254
Retained earnings		
Balance at beginning of year	$ 20,632	$ 65,879
Net loss for the period	(14,237)	(16,150)
Common share dividends	—	(10,000)
Balance at end of period	6,395	39,729
Accumulated other comprehensive income		
Balance at beginning of year	$ (693)	$ 4,195
Other comprehensive income (loss)	3,397	(12,967)
Balance at end of period	2,704	(8,772)
Total shareholders' equity at end of period	$ 85,557	$100,415

See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Comprehensive Income
Unaudited

Nine months ended September 30, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Net loss	$(14,237)	$(16,150)
Other comprehensive income, net of taxes:		
• Change in unrealized gains on available-for sale securities:		
Unrealized gains/(losses) arising during the year, net of income taxes(1)	3,701	(11,145)
Reclassification of net realized gains to net income, net of income taxes(2)	(304)	(1,822)
Other comprehensive income (loss)	3,397	(12,967)
Comprehensive income	$(10,840)	$(29,117)

(1) Net of income tax of $1,881 (2008 – (5,839))

(2) Net of income tax of $(160) (2008 – (966))

See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Cash Flows
Unaudited

Nine months ended September 30, 2009, with comparative figures for 2008
(In thousands of dollars)

	2009	2008
Cash provided by (used in):		
Operating activities:		
Net loss	$ (14,237)	$ (16,150)
Items not affecting cash:		
Amortization	552	874
Future income taxes	893	1,785
Net realized loss (gain) on sale of securities	841	(606)
Net realized gain on sale of capital assets	(20)	—
Amortization of bond premiums and discounts	12	(461)
	(11,959)	(14,558)
Change in non-cash balances:		
Deferred policy acquisition costs	6,856	(2,698)
Recoverable from reinsurers	17,677	(8,800)
Unearned premiums	(37,951)	(16,651)
Unpaid claims	2,438	25,718
Net change in other non-cash balances	40,360	(22,449)
	17,421	(39,438)
Financing activities:		
Contributed surplus	7,000	—
Dividends paid	—	(10,000)
	7,000	(10,000)
Investing activities:		
Purchase of securities	(580,563)	(505,090)
Proceeds from sale of securities	585,671	572,424
Financed premiums receivable, net	(4,220)	(8,155)
Proceeds from sale of capital assets	25	5
Additions to capital assets	1,910	(2,933)
	2,823	56,251
Increase (decrease) in cash position during the period	27,244	6,813
Cash, beginning of year	2,324	10,737
Cash, end of period	$ 29,568	$ 17,550

	2009	2008
Supplementary disclosure of cash information:		
Cash paid for:		
Income taxes	$ —	$ 4,751

See accompanying notes to financial statements.

Kingsway General Insurance Company (the "Company") was incorporated under the Corporations Act (Ontario) on August 19, 1986, and up to September 30, 2009 was licensed under the Insurance Act of Ontario. The Company is a wholly owned subsidiary of Kingsway Financial Services Inc. ("Kingsway Financial"), whose shares are listed on the Toronto and New York Stock Exchanges. Effective October 1, 2009, the Company entered into an Assumption Reinsurance agreement with Jevco Insurance Company ("Jevco"), a sister company, whereby Jevco assumed all the policy liabilities and supporting assets of the Company. The Company subsequently surrendered all of its provincial and territorial licenses.

1. Future accounting changes – International Financial Reporting Standards ("IFRS"):

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that a profit-oriented publicly accountable enterprise will be required to adopt IFRS. IFRS will replace current Canadian GAAP for those enterprises. For the Company, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. The Company is currently in the process of evaluating the impacts and implications of its conversion to IFRS.

2. Subsequent event – significant transaction:

Effective October 1, 2009 the Company commuted its reinsurance treaties with Kingsway Reinsurance Limited ("KRL") and Jevco. Also effective October 1, 2009, but subsequent to the commutation of the reinsurance treaties with KRL and Jevco, the Company entered into an Assumption Reinsurance agreement with Jevco whereby Jevco assumed all the policy liabilities and supporting assets of the Company. Jevco also purchased certain other capital assets of the Company. The Company subsequently surrendered all of its provincial licenses and declared and paid a dividend representing most of its shareholders equity.

3. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and meet the requirements of the Financial Services Commission of Ontario ("FSCO").

(a) 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. Key areas where management has made difficult, complex or subjective judgments, often as a result of matters inherently uncertain include income taxes, unpaid claims and investment impairment. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

(b) Securities:

All securities are designated as available-for-sale ("AFS") and are carried at their fair value whereby the unrealized gains and losses are included in Accumulated Other Comprehensive Income ("AOCI") until sale or other-than-temporary impairment is recognized, at which point cumulative unrealized gains or losses are transferred to the statement of operations. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect other-than-temporary impairments in value are included in "Net realized gain/ (loss) on sales of securities".

Dividends and interest income from these securities are included in "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 settlement 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 that show objective indications of possible impairment. An impairment is charged to income if the fair value of a security falls below its cost/amortized cost, and the decline is considered other-than-temporary. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been below cost; financial condition and near-term prospects of the issuer; and the company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

(c) Capital assets:

Capital assets are carried at cost less accumulated amortization. Amortization is provided on the following basis:

Buildings	Declining Balance	5%
Office equipment	Declining Balance	30%
Automobiles	Straight line	3 – 5 years
Furniture	Straight line	5 years
Leasehold improvements	Over the lease term	

(d) Deferred policy acquisition costs:

The Company defers brokers' commissions, premium taxes and other underwriting and marketing costs 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.

(e) Premium revenue and unearned premiums:

The Company earns motorcycle premiums over the period of risk covered by the policy based on the Company's experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract. Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the year end. A premium deficiency is established if the unearned premiums are less than the estimated future claims and expenses to be incurred as premiums are earned.

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.

In Canada, automobile insurance premium rates other than for fleet automobile are regulated by the provincial 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. Accordingly, a significant portion of the Company's revenue is subject to regulatory approvals.

(f) Unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate of 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 takes into consideration the time value of money using discount rates based on projected investment income from the assets supporting the provisions and includes an explicit provision for amounts recoverable at the same time using principles consistent with the Company's method for establishing the related liability.

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 light of emerging claim 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.

(g) Reinsurance ceded:

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 and deferred policy acquisition costs are also reported before reduction for business ceded to reinsurers and the reinsurers' portion is classified with amounts due from reinsurers and unearned reinsurance commissions, respectively.

Amounts recoverable from reinsurers are estimated in a manner consistent with the policy liabilities associated with the reinsured policy.

(h) 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 carry forwards. 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.

(i) Joint Ventures:

The Company's interest in joint a venture is included in these financial statements on a proportionate consolidation basis (note 17).

4. Role of the actuary and 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. With respect to the preparation of these financial statements, the independent actuary, Towers Perrin carries out a review of management's valuation of the unpaid claim liabilities and provides an opinion to the Board of Directors and the shareholders regarding the appropriateness of the 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. The independent actuary is responsible for assessing whether the assumptions and methods used for the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In performing the review of these 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, taking into consideration the circumstances of the Company and the nature of the insurance policies.

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 auditors

The external auditors have been appointed by the shareholders, pursuant to the Insurance Act of Ontario. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and to report thereon to the shareholders. In carrying out their audit, the auditors make use of the work of the actuary and his report on the policy liabilities of the Company. The auditors' report outlines the scope of their audit and their opinion.

(Tabular amounts in thousands of dollars)

5. Securities:

The table below provides the amortized cost and fair values of securities:

	September 30, 2009			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Term deposits and bankers' acceptances	$ 2,104	$ —	$ —	$ 2,104
Bonds:				
Canadian – Government	82,014	726	—	82,740
– Corporate	70,031	2,436	107	72,360
Other	12,413	698	—	13,111
US – Corporate	8,055	230	11	8,274
Others – Corporate	4,245	181	—	4,426
	$178,862	$4,281	$ 118	$183,015

	September 30, 2008			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Term deposits and bankers' acceptances	$ 7,454	$ 1	$ 7	$ 7,448
Bonds:				
Canadian – Government	41,431	506	103	41,834
– Corporate	52,328	269	1,597	51,000
Other	30,976	86	395	30,667
US – Corporate	12,054	100	1,233	10,921
Others – Corporate	8,869	267	551	8,585
Common shares				
Canadian	39,621	288	10,991	28,918
U.S.	1,325	123	40	1,408
Preferred shares				
Canadian	13	—	4	9
	$194,071	$1,640	$14,921	$180,790

Fair values of securities are considered to approximate quoted market values based on the latest bid prices in active markets. Fair value of securities for which no active market exists are derived from quoted market prices of similar securities or third party evidence.

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

- Assessing the Company's intent to sell those securities;
- Assessing whether it is more likely than not that the company will be required to sell those securities before the recovery of its amortized cost basis;
- Assessing if any credit losses are expected for those securities. The assessment includes consideration of, among other things, all available information and factors having a bearing upon collectability of security such as changes to credit rating by rating agencies, financial condition of the issuer, expected cash flows and value of any underlying collateral;
- identifying all security holdings in unrealized loss positions that have existed for at least six months or other circumstances that management believes may impact the recoverability of the security;
- obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;
- reviewing the trading range of certain securities over the preceding calendar period;
- assessing if declines in market value are other than temporary for debt security holdings based on their investment grade credit ratings from third party security rating agencies;
- assessing if declines in market value are other than temporary for any debt security holding with non-investment grade credit rating based on the continuity of its debt service record; 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.

As a result of the above analysis performed by management to determine declines in market value that are other than temporary, write downs for other-than-temporary impairments were $1.4 million (2008 – $3.4 million) and the entire amount of other-than-temporary impairments has been recognized in earnings.

(Tabular amounts in thousands of dollars)

6. Financial instruments:

(a) Financial risk management objectives and policies:

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

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

The tables below summarize the credit exposure of the Company from its investments in fixed income securities and term deposits by rating:

	2009		2008	
AAA	38,093	20.8%	$ 73,615	48.9%
AA	73,851	40.3%	18,030	12.0%
A	44,818	24.5%	44,918	29.9%
BBB	25,453	13.9%	12,708	8.4%
BB	—	0.0%	1,184	0.8%
Not rated	900	0.5	—	0.0%
Total	183,015	100.0%	$150,455	100.0%

As at September 30, 2009, 85.6% (2008 – 90.8%) of the fixed income portfolio is rated 'A' or better.

(Tabular amounts in thousands of dollars)

The table below summarizes the credit exposure of the Company for amounts receivable from reinsurers, by the rating, as assigned by A.M. Best to the applicable reinsurers.

	2009		2008	
A++	2,475	0.4%	$ 2,717	0.5%
A+	16,064	2.8%	17,637	3.1%
A	20,918	3.6%	22,967	4.0%
A-	7,008	1.2%	7,695	1.3%
B+	481,453	83.7%	520,198	90.4%
Not Rated	3,646	0.6%	4,004	0.7%
Total	$531,564	100.0%	$549,241	100.0%

Market risk:

The market risk exposure of the Company is primarily to the changes in interest rates. Market risk is subject to risk management. The Investment Committee of the Board and senior management of the company monitor the Company's market risk exposures and activities that give rise to these exposures.

Interest rate risk:

The company's primary market risk exposure is changes in interest rates. Because most of the securities portfolio is comprised of fixed income securities, periodic changes in interest rate levels generally impact the financial results to the extent that reinvestment yields are different than the original yields on maturing securities. Also, during periods of rising interest rates, the market value of the existing fixed income securities will generally decrease and realized gains on fixed income securities will likely be reduced. The reverse is true during periods of declining interest rates.

Duration is a measure used to estimate the extent market values of fixed income instruments change with changes in interest rates. Using this measure, it is estimated that an immediate hypothetical 100 basis point or 1 percent parallel increase in interest rates would decrease the market value of the fixed income securities by $9.0 million (2008—$3.8 million) representing 4.9% (2008 – 2.5%) of the $183.0 million (2008—$150.5 million) fair value of fixed income securities portfolio.

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

- The securities in the company's portfolio are not impaired;
- Credit and liquidity risks have not been considered;
- Interest rates and equity prices move independently; and
- Shifts in the yield curve are parallel.

In addition, it is important to note that available-for-sale securities in an unrealized loss position as reflected in Other Comprehensive Income, may at some point in the future be realized through a sale or impairment.

Equity prices risk:

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

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

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

At September 30, 2009, management estimates that a 10% increase in equity prices, with all other variables held constantly, would increase Other Comprehensive Income and Comprehensive Income before tax by $nil (2008 – $2.8 million). A 10% decrease in equity prices would have the corresponding opposite effect on Other Comprehensive Income and Comprehensive Income. Equities comprise nil% (2008 – 15.2%) of the company's investment portfolio as at September 30, 2009.

In February 2009, the Company elected to significantly reduce this equity price risk by liquidating the entire common equity portfolio.

Liquidity and cash flow risk:

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

(Tabular amounts in thousands of dollars)

Liquidity risk:

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):

	September 30, 2009						
	<=1 Year	1 - 2 Years	2 - 5 Years	5 - 10 Years	> 10 Years	No Specific Date	Total
Assets:							
Cash	29,568						29,568
Securities	2,104	20,304	61,304	97,131	2,042		183,015
Accrued investment income	1,899						1,899
Finance premiums	49,896						49,896
Accounts receivable & other assets	12,788					1,498	14,286
Claims recoverable	5,718	4,804	8,235	3,660	485		22,875
Due from related parties	(3,310)	25,015	(3,822)				17,883
Recoverable from reinsurers	178,201	98,942	169,614	75,384	9,423		531,564
Liabilities:							
Accounts payable & accrued liabilities	4,903						4,903
Due to related parties	—						—
Unpaid claims	176,761	148,480	254,537	113,128	14,141		707,047

	September 30, 2008						
	<=1 Year	1 - 2 Years	2 - 5 Years	5 - 10 Years	> 10 Years	No Specific Date	Total
Assets:							
Cash	17,550						17,550
Securities	20,890	21,232	63,708	43,749	885	30,336	180,789
Accrued investment income	1,839						1,839
Finance premiums	46,321						46,321
Accounts receivable & other assets	41,135					3,961	45,050
Claims recoverable	13,473	4,935	8,460	3,760	470		31,098
Due from related parties	7,979	23,915	1,019				32,913
Recoverable from reinsurers	208,762	102,607	175,899	78,177	9,772		575,217
Liabilities:							
Accounts payable & accrued liabilities	5,165						5,165
Due to related parties	3,418						3,418
Unpaid claims	184,336	154,842	265,443	117,975	14,747		737,343

The coupon rate for the fixed term investments is 3.1% as at September 30, 2008 (2008-range from 3.8% to 9.5%). The average effective yield (using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts) is 4.1% (2008 – 4.0%).

(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. 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 5 with respect to fair value disclosure on securities. There is no active market for policy liabilities, so, a market value is not available.

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

(c) Past due loans but not impaired:

Past due loans are loans where repayment of principal or payment of interest is contractually in arrears. There are no such loans as at September 30, 2009 (2008 – nil).

7. Capital management:

Objectives, policies & procedures:

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

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

Regulatory capital requirements & ratios:

As at September 30, 2009 the Company was adequately capitalized to support the premium volume. The Company is regulated by the Financial Services Commission of Ontario (FSCO) and is required to maintain a level of capital sufficient to achieve a ratio of 150% of a minimum capital test (MCT) formula. As at September 30, 2009 the MCT of the Company is above the required 150% MCT level.

(Tabular amounts in thousands of dollars)

8. Claims recoverable:

	2009	2008
Claims recoverable from policyholders	$ —	$ 7,599
Claims recoverable from other insurers on unpaid claims	22,875	23,499
	$22,875	$31,098

(i) Claims recoverable from policyholders

Some policies include conditions that require the policyholder to reimburse the Company up to an amount specified in the policy for certain third-party claims payments.

(ii) Claims recoverable from other insurers

In accordance with the Insurance Act of Ontario (the "Act"), the Company has a right of indemnification for certain benefits paid to its own insured from the insurer of a third party at fault. The Act also provides for an arbitration process when the two insurers are not in agreement as to the amount of losses to be transferred.

Failure of other insurers to honor their obligations could result in losses to the Company.

9. Capital assets:

	2009		
	Cost	Accumulated amortization	Net book value
Land (note 16)	$ 4,363	$ —	$ 4,363
Buildings (note 16)	28,336	2,926	25,410
Office equipment	1,093	1,005	88
Automobiles	179	163	16
Furniture	1,176	103	1,073
Leasehold improvements	29	29	—
	$31,176	$4,226	$30,950

	2008		
	Cost	Accumulated amortization	Net book value
Land (note 16)	$ 4,363	$ —	$ 4,363
Buildings (note 16)	28,636	1,369	27,267
Office equipment	1,093	996	97
Automobiles	382	321	61
Furniture	1,080	56	1,024
Leasehold improvements	29	23	6
	$35,583	$3,873	$32,818

(Tabular amounts in thousands of dollars)

10. Share capital:

Share capital consists of the following:

	September 30, 2009	September 30, 2008
Authorized:		
50,000,000 common shares at $1 par value		
Issued:		
178,010 common shares (2008 – 178,010)	$20,204	$20,204

11. 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 unfavorable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers.

Failure of reinsurers to honor their obligations could result in losses to the Company.

Underwriting risk:

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

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

Pricing risk:

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

Reinsurance risk:

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

(Tabular amounts in thousands of dollars)

The amounts recoverable from reinsurers are detailed as follows:

	2009	2008
Unearned premiums	$ 60,413	$ 86,610
Unpaid claims and adjustment expenses	471,151	488,607
	$531,564	$575,217

	2009	2008
Related reinsurers	$481,453	$520,165
Unrelated reinsurers	50,111	55,052
	$531,564	$575,217

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss.

Reinsurance arrangements with related companies, which are commonly controlled, remain in place and through these the Company cedes 65% of its net premiums to these related companies. These arrangements limit the maximum amount of net loss to $350,000 in the event of a liability or surety claim and $175,000 in the event of a property claim.

In addition, the Company has obtained catastrophe reinsurance, which together with affiliated companies, provides coverage in the event of a series of claims arising out of a single occurrence, which limits this exposure to $1,500,000 (2008 – $1,500,000) per occurrence for the Canadian subsidiaries of Kingsway Financial to a maximum aggregate of $125,000,000 (2008 – $125,000,000).

Reinsurance transactions deducted or included in items disclosed in the statement of operations were as follows:

	2009	2008
Net premiums earned		
Ceded – Related	$125,698	$164,424
Ceded – Other	10,613	14,082
Claims incurred		
Ceded – Related	109,053	134,269
Ceded – Other	1,739	6,639
Commissions and premium taxes		
Ceded – Related	27,609	34,718
Ceded – Other	166	181

(Tabular amounts in thousands of dollars)

12. Related party transactions:

In the normal course of business, the Company enters into reinsurance transactions on commercial terms with related parties. Details of the impact of these transactions on the financial statements are provided in Note 10. In addition, the Company had the following transactions with related parties:

	2009	2008
Management fees paid to Kingsway Financial	$30,895	$44,601
Rental income and reimbursement of general expenses received from a commonly controlled company	$ —	$ 270
Adjusting fees paid to a commonly controlled company	$ 647	$ 1,456

The Company has a management agreement with its parent company, whereby the Company pays management fee equal to the lesser of 115% or the direct costs and expenses, or fair market value incurred or paid by the parent in the provision of goods and services, facilities, supplies, equipment, premises and repairs in accordance with the said agreement. Management fees include $8,421,000 (2008 – $12,991,000) relating to internal loss adjustment expenses charged to claims incurred and $900,000 (2008 – $900,000) relating to investment management expenses charged to investment income.

All related party balances are non-interest bearing and are payable monthly in arrears.

13. Income taxes:

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

	2009	2008
Income before income taxes	$(22,016)	$(24,583)
Statutory tax rate	34.9%	34.9%
Provision based on statutory rate	$ (7,683)	$ (8,579)
Impact of changes in rate	(107)	216
Non-taxable securities income	24	(103)
Non-taxable gain	—	—
Other	(13)	33
Income tax expense	$ (7,779)	$ (8,443)

(Tabular amounts in thousands of dollars)

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

	2009	2008
Future income tax assets:		
Unpaid claims	$3,694	$3,559
Securities	(310)	889
Other	1,610	754
Future income tax assets	4,994	5,202
Future income tax liabilities:		
Securities	—	—
Future income tax liabilities	—	—
Net future income tax assets	$4,994	$5,202

14. Unpaid claims:

(a) Nature of unpaid claims:

The establishment of the provision for unpaid claims and adjustment expenses 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, investment rates of return, 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-tailed claims, such as general liability and automobile accident benefit claims.

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

Reserving risk arises due to the length of time between the occurrences of a loss, the reporting of the loss to the insurer and ultimate resolution of the claim. Claim provisions are expectations of the ultimate cost of resolution and administration of claims based on an assessment of facts and circumstances then known, a review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

(Tabular amounts in thousands of dollars)

Variables in the reserve estimation process can be affected by receipt of additional claim information and other internal and external factors, such as changes in claims handling procedures, economic inflation, legal and judicial trends, legislative changes, inclusion of exposures not contemplated at the time of policy inception and significant changes in severity or frequency of claims relative to historical trends. Due to the amount of time between the occurrence of a loss, the actual reporting of the loss and the ultimate payment, provisions may ultimately develop differently from the actuarial assumptions made when initially estimating the provision for claims. The Company's provision for claims are reviewed separately by, and must be acceptable to internal actuaries at the Company, the independent appointed actuary, and an external valuation actuary.

(b) Provision for unpaid claims and adjustment expenses:

The provision for unpaid claims and adjustment expenses is discounted using rates based on the Company's projected investment income from the assets supporting the provisions, and reflecting the estimated timing of payments and recoveries. The discount rate used was 4.8% (2008 – 4.9%). Reinsurance recoverable estimates are discounted based on a rate using the Company's investment portfolio yield.

Margins for adverse development are included in the provision for unpaid claims and adjustment expenses and in the reinsurance recoverable estimates to allow for possible deterioration of experience relating to asset default, reinvestment risk, claims development and recoverability of reinsurance balances.

The gross provision and reinsurance recoverable estimates are as follows:

	2009		2008	
	Undiscounted	**Discounted**	**Undiscounted**	**Discounted**
Gross Provision	$691,577	$707,047	$729,872	$737,343
Reinsurance ceded	462,106	471,151	483,419	488,607

The Company has a concentration of business in automobile, trucking and property insurance in the provinces of Ontario and Alberta.

(Tabular amounts in thousands of dollars)

An annual evaluation of the adequacy of policy liabilities is completed at the end of each financial year. This evaluation 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 provisions for unpaid claims for the periods ended September 30, were as follows:

	2009	2008
Unpaid claims, beginning of year		
Gross	$ 704,609	$ 711,625
Reinsurance ceded	(464,479)	(473,847)
Other claims recoverable	(22,270)	(15,449)
Unpaid claims, beginning of year – net	217,860	222,329
Provision for claims occurring:		
In the current period	57,156	75,812
In prior years	3,436	883
Claims paid during the period	(58,942)	(76,272)
Change in recovery of claims paid from other insurers	(6,489)	2,485
Unpaid claims, end of period – net	213,021	225,237
Reinsurers' share of unpaid claims	471,151	488,607
Other insurers' share of unpaid claims (note 7)	22,875	23,499
Provision for unpaid claims, end of period	$ 707,047	$ 737,343

	2009	2008
Automobile	$ 637,899	$ 674,318
Property	23,851	29,336
Liability	44,536	32,021
Other	762	1,668
Provision for unpaid claims – end of period	$ 707,047	$ 737,343

(Tabular amounts in thousands of dollars)

The Company's direct written premiums are derived from the following business lines:

	2009	2008
Business Line		
Personal Lines:		
Non-Standard Auto	55.3%	40.3%
Motorcycle	13.2%	11.6%
Property (including Liability)	0.0%	0.3%
Total Personal Lines	68.5%	52.2%
Commercial Lines:		
Trucking	9.9%	20.8%
Commercial Auto	11.7%	11.6%
Property (including Liability)	7.2%	13.3%
Other Specialty Lines	2.7%	2.1%
Total Commercial Lines	31.5%	47.8%
Total Direct Premiums Written	100.0%	100.0%

(c) Fair value of unpaid claims:

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.

15. Statutory requirements:

The Company is regulated by the Financial Services Commission of Ontario (FSCO) and is required to maintain a level of capital sufficient to achieve a target of 150% of a minimum capital test (MCT) formula. The Company was in compliance at the end of September 2009 and 2008 achieving 207% and 169% respectively.

16. Commitments and contingent liabilities:

(a) In connection with its operations, the Company is from time to time named as defendant 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.

The Company has purchased a number of annuities in settlement of claims. These annuities have been purchased from life insurance companies with the highest claims paying ability ratings as determined by outside ratings organizations. The Company has a contingent credit risk with respect to the failure of these life insurers which management have assessed as being immaterial. The Company believes it is not practical to determine the fair value of its financial guarantees or the maximum contingent potential payment of this guarantee on the structured settlements.

(Tabular amounts in thousands of dollars)

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

(b) As at September 30, 2009, bonds and term deposits with an estimated fair value of $0.2 million (2008 – $0.2 million) were on deposit with regulatory authorities. Also, from time to time, the Company pledges assets to third parties to collateralize liabilities incurred under its policies of insurance or for the services provided by them to the company. At September 30, 2009, the amount of such pledged assets was $Nil (2008 – $Nil). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company's standard risk management controls.

17. Joint ventures:

The Company has a 75% ownership in a real estate joint venture with a related party which is commonly controlled and as such is accounted for as a joint venture. The following amounts represent the Company's proportionate interest:

	2009	2008
Current assets	2,576	2,107
Capital assets	27,886	29,556
Current liabilities	43	—
Investment Income	(1,393)	17
Cash flows resulting from operating activities	(2,071)	(2,141)
Cash flows resulting from investing activities	27	1,259

The capital assets include land of $3,756,000 (2008 – $3,756,000) and building of $25,101,000 (2008 – $25,105,000).

As a result of analysis performed by management to determine the decline in market value of the real estate venture that are other than temporary, write downs for other-than-temporary impairments were $1.4 million (2008 – $nil) and the entire amount of other-than-temporary impairments has been recognized in earnings.

Schedule "C"

Audited financial statements of
Kingsway General Insurance Company

Financial Statements of

KINGSWAY GENERAL INSURANCE COMPANY

Year ended December 31, 2008

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheet of Kingsway General Insurance Company as at December 31, 2008 and the statements of operations, changes in shareholders' equity, comprehensive income (loss) and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

/s/ KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

February 11, 2009

APPOINTED ACTUARY'S REPORT

To the Shareholders of
Kingsway General Insurance Company

I have valued the policy liabilities of Kingsway General Insurance Company for its balance sheet at December 31, 2008 and their change in the statement of operations for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities makes appropriate provision for all policyholders' obligations, and the financial statements fairly present the results of the valuation.

Pierre G. Laurin, FCIA, FCAS
Principal and Head of the Canadian P&C Practice

February 11, 2009

KINGSWAY GENERAL INSURANCE COMPANY
Balance Sheet

As at December 31, 2008, with comparative figures for 2007
(In thousands of dollars)

	2008	2007
Assets		
Cash	$ 2,324	$ 10,737
Securities (notes 6 and 7)	183,858	266,828
Accrued investment income	1,221	1,584
Financed premiums	45,676	38,166
Accounts receivable and other assets	37,698	46,390
Claims recoverable (note 9)	28,759	20,563
Income taxes recoverable	23,797	4,695
Future income taxes (note 14)	5,887	3,718
Due from related parties (note 13)	29,125	24,904
Recoverable from reinsurers (notes 12 and 15)	549,241	571,492
Deferred policy acquisition costs	21,604	25,912
Capital assets (note 10)	32,860	34,840
	$962,050	$1,049,829
Liabilities and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 7,364	$ 12,219
Due to related parties (note 13)	504	2,632
Unearned premiums (note 12)	134,747	154,521
Unpaid claims (notes 12 and 15)	704,609	711,625
Unearned reinsurance commissions	25,429	29,300
	872,653	910,297
Shareholders' equity:		
Share capital (note 11)	20,204	20,204
Contributed surplus	49,254	49,254
Retained earnings	20,632	65,879
Accumulated other comprehensive income (loss)	(693)	4,195
	89,397	139,532
	$962,050	$1,049,829

Commitments and contingent liabilities (note 17)
See accompanying notes to financial statements.

On behalf of the Board:

/s/ John McGlynn Director

/s/ Shaun Jackson Director

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Operations

Year ended December 31, 2008, with comparative figures for 2007
(In thousands of dollars)

	2008	2007
Direct premiums written	$317,725	$392,722
Net premiums written	$102,192	$126,053
Revenue:		
Net premiums earned (notes 12 and 13)	$109,083	$120,769
Investment income	8,087	11,872
Net realized gain (loss) on sales of securities	(18,784)	8,256
Premium finance income	4,714	4,152
Gain on sale of capital assets	4	6,336
	103,104	151,385
Expenses:		
Claims incurred (notes 12, 13 and 15)	103,196	96,485
Commissions and premium taxes (recovery) (notes 12 and 13)	1,082	(15,036)
Management fees (note 13)	41,876	34,373
General and administrative expenses (note 13)	10,493	11,859
	156,647	127,681
Income (loss) before income taxes	(53,543)	23,704
Income taxes (recovery) (note 14):		
Current	(16,478)	7,241
Future	(1,818)	65
	(18,296)	7,306
Net income (loss)	$ (35,247)	$ 16,398

See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Changes in Shareholder's Equity

Year ended December 31, 2008, with comparative figures for 2007
(In thousands of dollars)

	2008	2007
Share capital		
Balance at beginning of year	$ 20,204	$ 20,204
Issued during the year	—	—
Balance at end of year	20,204	20,204
Contributed surplus		
Balance at beginning of year	$ 49,254	$ 49,254
Contributions during the year	—	—
Balance at end of year	49,254	49,254
Retained earnings		
Balance at beginning of year	$ 65,879	$ 59,481
Net income loss for the year	(35,247)	16,398
Common share dividends	(10,000)	(10,000)
Balance at end of year	20,632	65,879
Accumulated other comprehensive income (loss)[1]		
Balance at beginning of year	$ 4,195	$ —
Cumulative effect of adopting new accounting policies (note 1)	—	4,198
Other comprehensive income (loss)	(4,888)	(3)
Balance at end of year	(693)	4,195
Total shareholders' equity at end of year	$ 89,397	$139,532

(1) Refer to note 1 for impact of new accounting policies related to financial instruments

See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Comprehensive Income (Loss)

Year ended December 31, 2008, with comparative figures for 2007
(In thousands of dollars)

	2008	2007
Net income (loss)	$(35,247)	$16,398
Other comprehensive income (loss), net of taxes:		
• Change in unrealized gains on available-for sale securities:		
Unrealized gains/(losses) arising during the year, net of income taxes(1)	(152)	854
Reclassification of net realized gains to net income, net of income taxes(2)	(4,736)	(857)
Other comprehensive income (loss)	(4,888)	(3)
Comprehensive income (loss)	$(40,135)	$16,395

(1) Net of income tax of $(85) (2007 – 525)

(2) Net of income tax of $(2,484) (2007 – (476))

See accompanying notes to financial statements.

KINGSWAY GENERAL INSURANCE COMPANY
Statement of Cash Flows

Year ended December 31, 2008, with comparative figures for 2007
(In thousands of dollars)

	2008	2007
Cash provided by (used in):		
Operating activities:		
Net income (loss)	$ (35,247)	$ 16,398
Items not affecting cash:		
Amortization	1,061	994
Future income taxes	(2,169)	2,788
Net realized loss (gain) on sale of securities	18,784	(8,256)
Net realized gain on sale of capital assets	(4)	(6,336)
Amortization of bond premiums and discounts	(476)	(735)
	(18,051)	4,853
Change in non-cash balances:		
Deferred policy acquisition costs	4,308	(2,108)
Recoverable from reinsurers	22,251	(5,816)
Unearned premiums	(19,774)	12,743
Unpaid claims	(7,016)	(12,870)
Net change in other non-cash balances	(31,777)	(154)
	(50,059)	(3,352)
Financing activities:		
Dividends paid	(10,000)	(10,000)
	(10,000)	(10,000)
Investing activities:		
Purchase of securities	(661,446)	(656,769)
Proceeds from sale of securities	718,651	685,266
Financed premiums receivable, net	(7,510)	(13,595)
Proceeds from sale of capital assets	5	10,026
Additions to capital assets	1,946	(7,692)
	51,646	17,236
Increase (decrease) in cash position during the year	(8,413)	3,884
Cash, beginning of year	10,737	6,853
Cash, end of year	$ 2,324	$ 10,737

	2008	2007
Supplementary disclosure of cash information:		
Cash paid for:		
Interest	$ —	$ —
Income taxes	4,751	10,892

See accompanying notes to financial statements.

Kingsway General Insurance Company (the "Company") was incorporated under the Corporations Act (Ontario) on August 19, 1986, and is licensed under the Insurance Act of Ontario. The Company is licensed in all provinces and territories in Canada to write all classes of insurance, other than life. The Company is a wholly owned subsidiary of Kingsway Financial Services Inc. ("Kingsway Financial"), whose shares are listed on the Toronto and New York Stock Exchanges.

1. Change in accounting policies:

On January 1, 2008, the Company adopted CICA Handbook Section 1535 Capital Disclosures, Section 3862 Financial Instruments – Disclosures and Section 3863 Financial Instruments – Presentation.

Handbook Section 1535 requires the following disclosures: (i) qualitative information about an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity manages as capital; (iii) whether the entity has complied with any externally imposed capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. See note 8 for additional details.

Handbook Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements but not changing the existing presentation requirements for financial instruments. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Handbook Section 3862 requires qualitative and quantitative disclosure of: (i) exposures to risks arising from financial instruments, how they arose and the potential impact on the amount, timing and certainty of future cash flows; (ii) information about the risk management function and the reporting and measurement systems used; (iii) the entity's policies for hedging or mitigating risk and avoiding concentrations of risk; and (iv) the sensitivity to individual market risk factors together with the methodology for performing the analysis. Handbook Section 3863 deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. See note 7 for additional details.

2. Future accounting changes – International Financial Reporting Standards ("IFRS"):

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that a profit-oriented publicly accountable enterprise will be required to adopt IFRS. IFRS will replace current Canadian GAAP for those enterprises. For the Company, IFRS will be effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. The Company is currently in the process of evaluating the impacts and implications of its conversion to IFRS.

3. Accounting changes effective in 2007:

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

4. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and meet the requirements of the Financial Services Commission of Ontario ("FSCO").

(a) 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. Key areas where management has made difficult, complex or subjective judgments, often as a result of matters inherently uncertain include income taxes, unpaid claims and investment impairment. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

(b) Securities:

All financial instruments are designated as available-for-sale ("AFS") securities. AFS securities are carried at fair value whereby the unrealized gains and losses are included in Accumulated Other Comprehensive Income ("AOCI") until sale or other-than-temporary impairment is recognized, at which point cumulative unrealized gains or losses are transferred to the statement of operations. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect other-than-temporary impairments in value are included in "Net realized gain (loss) on sales of securities".

Dividends and interest income from these securities are included in "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 settlement date accounting.

(b) Securities:

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

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

Prior to 2007, fixed term investments were carried at amortized cost. Investments in common and preferred shares were carried at cost.

(c) Capital assets:

Capital assets are carried at cost less accumulated amortization. Amortization is provided on the following basis:

Buildings	Declining Balance	5%
Office equipment	Declining Balance	30%
Automobiles	Straight line	3 –5 years
Furniture	Straight line	5 years
Leasehold improvements	Over the lease term	

(d) Deferred policy acquisition costs:

The Company defers brokers' commissions, premium taxes and other underwriting and marketing costs 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.

(e) Premium revenue and unearned premiums:

The Company earns motorcycle premiums over the period of risk covered by the policy based on the Company's experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract. Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the year end. A premium deficiency is established if the unearned premiums are less than the estimated future claims and expenses to be incurred as premiums are earned.

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.

In Canada, automobile insurance premium rates other than for fleet automobile are regulated by the provincial 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. Accordingly, a significant portion of the Company's revenue is subject to regulatory approvals.

(f) Unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate of 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 takes into consideration the time value of money using discount rates based on projected investment income from the assets supporting the provisions and includes an explicit provision for adverse deviation. Expected reinsurance recoveries on unpaid claims are recognized as amounts recoverable at the same time using principles consistent with the Company's method for establishing the related liability.

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 light of emerging claim 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.

(g) Reinsurance ceded:

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 and deferred policy acquisition costs are also reported before reduction for business ceded to reinsurers and the reinsurers' portion is classified with amounts due from reinsurers and unearned reinsurance commissions, respectively.

Amounts recoverable from reinsurers are estimated in a manner consistent with the policy liabilities associated with the reinsured policy.

(h) 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 carry forwards. 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.

(i) Joint Ventures:

The Company's interest in joint a venture is included in these financial statements on a proportionate consolidation basis (note 16).

5. Role of the actuary and 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. With respect to the preparation of these financial statements, the independent actuary, Towers Perrin carries out a review of management's valuation of the unpaid claim liabilities and provides an opinion to the Board of Directors and the shareholders regarding the appropriateness of the 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. The independent actuary is responsible for assessing whether the assumptions and methods used for the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In performing the review of these 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, taking into consideration the circumstances of the Company and the nature of the insurance policies.

(Tabular amounts in thousands of dollars)

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 auditors

The external auditors have been appointed by the shareholders, pursuant to the Insurance Act of Ontario. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and to report thereon to the shareholders. In carrying out their audit, the auditors make use of the work of the actuary and his report on the policy liabilities of the Company. The auditors' report outlines the scope of their audit and their opinion.

6. Securities:

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

	December 31, 2008			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Term deposits and bankers' acceptances	$ 23,163	$ 65	$ 1	$ 23,227
Bonds:				
Canadian – Government	47,567	2,001	—	49,568
– Corporate	67,744	690	2,972	65,462
US – Corporate	9,708	6	916	8,798
Others – Corporate	9,628	224	946	8,906
Common shares				
Canadian	24,810	538	—	25,348
U.S.	2,190	351	—	2,541
Preferred shares				
Canadian	13	2	7	8
	$184,823	$3,877	$4,842	$183,858

(Tabular amounts in thousands of dollars)

		December 31, 2007			
		Amortized cost	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Term deposits and bankers' acceptances		$ 39,569	$ 39	$ 6	$ 39,602
Bonds:					
Canadian	– Government	65,938	882	23	66,797
	– Corporate	85,431	417	1,208	84,640
US	– Corporate	13,941	63	437	13,567
Others	– Corporate	12,417	181	94	12,504
Common shares					
Canadian		42,202	8,182	1,632	48,752
U.S.		826	130	—	956
Preferred shares					
Canadian		13	—	3	10
		$260,337	$9,894	$3,403	$266,828

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

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

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

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

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

In February, 2009, the Company elected to liquidate its entire common equity securities portfolio. Based upon this decision, management has concluded that the intent to hold the common equity securities portfolio to recovery no longer exists. As a result all common equity securities in an unrealized loss position as at December 31, 2008 are considered to be other than temporarily impaired.

As a result of the above analysis performed by management to determine declines in market value that are other than temporary, write downs for other-than-temporary impairments were $19.4 million (2007 – $3.5 million). These impairment charges included $19.4 million (2007-$3.5 million) from the write down of common stocks and $Nil (2007 – $Nil) from write down of debt securities.

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

7. Financial instruments:

(a) Financial risk management objectives and policies:

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

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

Credit risk:

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

(Tabular amounts in thousands of dollars)

The table below summarizes the credit exposure of the Company from its debt securities and term deposits by the rating as assigned by Standard & Poors or Moody's Investor Services, using the higher of these ratings for any security where there is a split rating.

	2008		2007	
AAA/Aaa	$ 87,652	56.2%	$106,188	48.9%
AA/Aa	21,205	13.6%	45,538	21.0%
A/A	35,635	22.9%	53,111	24.4%
BBB/Baa	10,201	6.5%	11,036	5.1%
BB/Ba	1,268	0.8%	1,237	0.6%
Total	$155,961	100.0%	$217,110	100.0%

The table below summarizes the credit exposure of the Company for amounts receivable from reinsurers by the rating as assigned by A.M. Best to the applicable reinsurers:

	2008		2007	
A++	$ 2,669	0.5%	$ 1,967	0.3%
A+	17,326	3.2%	35,335	6.2%
A	22,562	4.1%	22,779	4.0%
A-	7,559	1.4%	5,453	1.0%
B++	—	—	505,958	88.5%
B+	495,192	90.2%	—	—
Not Rated	3,933	0.7%	—	—
Total	$549,241	100%	$571,492	100.0%

Market risk:

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

Interest rate risk:

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

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:

(i) An immediate hypothetical 100 basis point parallel increase in interest rates would decrease the market value of our fixed income securities by $6.7 million (2007 – $8.3 million), representing 4.3% (2007 – 3.8%) of the $156 million (2007 – $217.1 million) fair value fixed income securities portfolio.

(ii) An immediate hypothetical 100 basis point parallel decrease in interest rates would increase the market value of our unpaid claims by $15.0 million (2007 – $15.0 million), representing 2.1% (2007 – 2.1%) of the $704.6 million (2007 – $711.6 million) of unpaid claims liabilities carried on the balance sheet.

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

(a) The securities in the Company's portfolio are not impaired;

(b) Credit and liquidity risks have not been considered;

Market risk:

(c) Interest rates and equity prices move independently;

(d) Shifts in the yield curve are parallel.

In addition, it is important to note that available-for-sale securities in an unrealized loss position as reflected in Other Comprehensive Income, may at some point in the future be realized through a sale or impairment.

Equity prices risk:

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

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

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

At December 31, 2008, management estimates that a 10% increase in equity prices, with all other variables held constantly, would increase Other Comprehensive Income and Comprehensive Income before tax by $2.8 million (2007 – $5.0 million). A 10% decrease in equity prices would have the corresponding opposite effect on Other Comprehensive Income and Comprehensive Income. Equities comprise 15.2% (2007 – 18.6%) of the company's investment portfolio as at December 31, 2008.

In February 2009, the Company elected to significantly reduce this equity price risk by liquidating the entire common equity portfolio.

Liquidity risk:

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

(Tabular amounts in thousands of dollars)

The following table summarizes carrying amounts of financial instruments by maturity or expected cash flow dates (the actual re pricing 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):

	<=1 Year	1 - 2 Years	2 - 5 Years	5 - 10 Years	> 10 Years	No Specific Date	2008 Total	2007 Total
Assets:								
Cash	2,324						2,324	10,737
Securities	26,177	9,526	54,279	57,792	8,187	27,897	183,858	266,828
Accrued investment income	1,221						1,221	1,584
Finance premiums	45,676						45,676	38,166
Accounts receivable & other assets	34,337					3,361	37,698	46,390
Claims recoverable	12,057	4,677	8,017	3,563	445		28,759	20,563
Due from related parties	3,047	24,897	1,181				29,125	24,904
Recoverable from reinsurers	200,881	97,541	167,212	74,317	9,290		549,241	571,492
Liabilities:								
Accounts payable & accrued liabilities	7,364						7,364	12,219
Due to related parties	504						504	2,632
Unpaid claims	176,153	147,968	253,659	112,737	14,092		704,609	711,625

The coupon rates for the Company's' fixed term investments range from 3.8% to 9.5% at December 31, 2008 (4.0% to 9.5% at December 31, 2007). The average effective yield (using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts) is 4.2% (2007 – 4.8%).

(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.

(Tabular amounts in thousands of dollars)

Refer to Note 6 with respect to fair value disclosure on securities. There is no active market for policy liabilities, so, a market value is not available.

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

(c) Past due loans but not impaired:

Past due loans are loans where repayment of principal or payment of interest is contractually in arrears. There are no such loans as at December 31, 2008 (2007 – Nil).

8. Capital management:

Objectives, policies & procedures:

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

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

Regulatory capital requirements & ratios:

As at December 31, 2008 the Company was adequately capitalized to support the premium volume. The Company is regulated by the Financial Services Commission of Ontario (FSCO) and is required to maintain a level of capital sufficient to achieve a ratio of 150% of a minimum capital test (MCT) formula. As at December 31, 2008 the MCT of the Company is above the required 150% MCT level.

9. Claims recoverable:

	2008	2007
Claims recoverable from policyholders	$ 6,489	$ 5,114
Claims recoverable from other insurers on unpaid claims	22,270	15,449
	$28,759	$20,563

(i) Claims recoverable from policyholders

Some policies include conditions that require the policyholder to reimburse the Company up to an amount specified in the policy for certain third-party claims payments.

(Tabular amounts in thousands of dollars)

(ii) Claims recoverable from other insurers

In accordance with the Insurance Act of Ontario (the "Act"), the Company has a right of indemnification for certain benefits paid to its own insured from the insurer of a third party at fault. The Act also provides for an arbitration process when the two insurers are not in agreement as to the amount of losses to be transferred.

Failure of other insurers to honor their obligations could result in losses to the Company.

10. Capital assets:

	2008		
	Cost	**Accumulated amortization**	**Net book value**
Land (note 16)	$ 4,363	$ —	$ 4,363
Buildings (note 16)	29,726	2,476	27,250
Office equipment	1,093	1,005	88
Automobiles	349	301	48
Furniture	1,173	64	1,109
Leasehold improvements	29	27	2
	$36,733	$3,873	$32,860

	2007		
	Cost	**Accumulated amortization**	**Net book value**
Land (note 16)	$ 4,363	$ —	$ 4,363
Buildings (note 16)	30,437	1,512	28,925
Office equipment	1,093	968	125
Automobiles	383	271	112
Furniture	1,426	128	1,298
Leasehold improvements	29	12	17
	$37,731	$2,891	$34,840

11. Share capital:

Share capital consists of the following:

	December 31,	
	2008	**2007**
Authorized:		
50,000,000 common shares at $1 par value		
Issued:		
178,010 common shares (2007 – 178,010)	$20,204	$20,204

12. 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 unfavorable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers.

Failure of reinsurers to honor their obligations could result in losses to the Company.

Underwriting risk:

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

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

Pricing risk:

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

Reinsurance risk:

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

(Tabular amounts in thousands of dollars)

The amounts recoverable from reinsurers are detailed as follows:

	2008	2007
Unearned premiums	$ 84,762	$ 97,645
Unpaid claims and adjustment expenses	464,479	473,847
	$549,241	$571,492

	2008	2007
Related reinsurers	$494,682	$505,958
Unrelated reinsurers	54,559	65,534
	$549,241	$571,492

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss.

Reinsurance arrangements with related companies, which are commonly controlled, remain in place and through these the Company cedes 65% of its net premiums to these related companies. These arrangements limit the maximum amount of net loss to $350,000 in the event of a liability or surety claim and $175,000 in the event of a property claim.

In addition, the Company has obtained catastrophe reinsurance, which together with affiliated companies, provides coverage in the event of a series of claims arising out of a single occurrence, which limits this exposure to $1,500,000 (2007 – $1,500,000) per occurrence for the Canadian subsidiaries of Kingsway Financial to a maximum aggregate of $125,000,000 (2007 – $125,000,000).

Reinsurance transactions deducted or included in items disclosed in the statement of operations were as follows:

	2008	2007
Net premiums earned		
Ceded – Related	$211,318	$ 237,444
Ceded – Other	17,098	10221,767
Claims incurred		
Ceded – Related	160,897	145,639
Ceded – Other	13,020	12,136
Commissions and premium taxes		
Ceded – Related	48,475	69,849
Ceded – Other	256	972

(Tabular amounts in thousands of dollars)

13. Related party transactions:

In the normal course of business, the Company enters into reinsurance transactions on commercial terms with related parties. Details of the impact of these transactions on the financial statements are provided in Note 10. In addition, the Company had the following transactions with related parties:

	2008	2007
Management fees paid to Kingsway Financial	$60,331	$53,096
Rental income and reimbursement of general expenses received from a commonly controlled company	$ 270	$ 360
Adjusting fees paid to a commonly controlled company	$ 1,919	$ 1,695

The Company has a management agreement with its parent company, whereby the Company pays management fee equal to the lesser of 115% or the direct costs and expenses, or fair market value incurred or paid by the parent in the provision of goods and services, facilities, supplies, equipment, premises and repairs in accordance with the said agreement. Management fees include $17,305,000 (2007 – $17,244,000) relating to internal loss adjustment expenses charged to claims incurred and $1,200,000 (2007 – $1,200,000) relating to investment management expenses charged to investment income.

All related party balances are non-interest bearing and are payable monthly in arrears.

14. Income taxes:

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

	2008	2007
Income before income taxes	$(53,543)	$23,704
Statutory tax rate	34.9%	35.0%
Provision based on statutory rate	$(18,676)	$ 8,308
Impact of changes in rate	395	—
Non-taxable securities income	(134)	(74)
Non-taxable gain	—	(978)
Other	119	50
Income tax expense	$(18,296)	$ 7,306

(Tabular amounts in thousands of dollars)

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

	2008	2007
Future income tax assets:		
Unpaid claims	$3,410	$3,580
Securities	1,537	—
Other	940	219
Future income tax assets	5,887	3,799
Future income tax liabilities:		
Securities	—	(81)
Future income tax liabilities	—	(81)
Net future income tax assets	$5,887	$3,718

15. Unpaid claims:

(a) Nature of unpaid claims:

The establishment of the provision for unpaid claims and adjustment expenses 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, investment rates of return, 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-tailed claims, such as general liability and automobile accident benefit claims.

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

Reserving risk arises due to the length of time between the occurrences of a loss, the reporting of the loss to the insurer and ultimate resolution of the claim. Claim provisions are expectations of the ultimate cost of resolution and administration of claims based on an assessment of facts and circumstances then known, a review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

(Tabular amounts in thousands of dollars)

Variables in the reserve estimation process can be affected by receipt of additional claim information and other internal and external factors, such as changes in claims handling procedures, economic inflation, legal and judicial trends, legislative changes, inclusion of exposures not contemplated at the time of policy inception and significant changes in severity or frequency of claims relative to historical trends. Due to the amount of time between the occurrence of a loss, the actual reporting of the loss and the ultimate payment, provisions may ultimately develop differently from the actuarial assumptions made when initially estimating the provision for claims. The Company's provision for claims are reviewed separately by, and must be acceptable to internal actuaries at the Company, the independent appointed actuary, and an external valuation actuary.

(b) Provision for unpaid claims and adjustment expenses:

The provision for unpaid claims and adjustment expenses is discounted using rates based on the Company's projected investment income from the assets supporting the provisions, and reflecting the estimated timing of payments and recoveries. The discount rate used was 4.8% (2007 – 4.9%). Reinsurance recoverable estimates are discounted based on a rate using the Company's investment portfolio yield.

Margins for adverse development are included in the provision for unpaid claims and adjustment expenses and in the reinsurance recoverable estimates to allow for possible deterioration of experience relating to asset default, reinvestment risk, claims development and recoverability of reinsurance balances.

The gross provision and reinsurance recoverable estimates are as follows:

	2008		2007	
	Undiscounted	**Discounted**	**Undiscounted**	**Discounted**
Gross Provision	$692,369	$704,609	$703,275	$711,625
Reinsurance ceded	458,428	464,479	469,859	473,847

The Company has a concentration of business in automobile, trucking and property insurance in the provinces of Ontario and Alberta.

(Tabular amounts in thousands of dollars)

An annual evaluation of the adequacy of policy liabilities is completed at the end of each financial year. This evaluation 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 provisions for unpaid claims for the years ended December 31, were as follows:

	2008	2007
Unpaid claims, beginning of year		
Gross	$ 711,625	$ 724,495
Reinsurance ceded	(473,847)	(475,490)
Other claims recoverable	(15,449)	(19,430)
Unpaid claims, beginning of year – net	222,329	229,575
Provision for claims occurring:		
In the current year	137,221	107,160
In prior years	(34,025)	(10,675)
Claims paid during the year	(109,040)	(105,602)
Change in recovery of claims paid from other insurers	1,375	1,871
Unpaid claims, end of year – net	217,860	222,329
Reinsurers' share of unpaid claims	64,479	473,847
Other insurers' share of unpaid claims (note 7)	22,270	15,449
Provision for unpaid claims, end of year	$ 704,609	$ 711,625

	2008	2007
Automobile	$ 635,699	$ 650,798
Property	23,769	28,313
Liability	44,382	30,904
Other	759	1,610
Provision for unpaid claims – end of year	$ 704,609	$ 711,625

(Tabular amounts in thousands of dollars)

The Company's direct written premiums are derived from the following business lines:

	2008	2007
Business Line		
Personal Lines:		
Non-Standard Auto	41.8%	35.4%
Motorcycle	9.3%	8.1%
Property (including Liability)	0.3%	0.3%
Total Personal Lines	51.4%	43.8%
Commercial Lines:		
Trucking	22.0%	31.1%
Commercial Auto	11.6%	9.5%
Property (including Liability)	12.9%	14.1%
Other Specialty Lines	2.1%	1.5%
Total Commercial Lines	48.6%	56.2%
Total Direct Premiums Written	100.0%	100.0%

(c) Fair value of unpaid claims:

The provision for unpaid claims and adjustment expenses is based on the present value of future cash flows plus provision for adverse deviations, and is considered an indicator of fair value since there is no ready market for the trading of insurance policy liabilities.

16. Statutory requirements:

The Company is regulated by the Financial Services Commission of Ontario (FSCO) and is required to maintain a level of capital sufficient to achieve a target of 150% of a minimum capital test (MCT) formula. The Company was in compliance at the end of 2008 and 2007 achieving 186% and 266% respectively.

17. Commitments and contingent liabilities:

(a) In connection with its operations, the Company is from time to time named as defendant 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.

The Company has purchased a number of annuities in settlement of claims. These annuities have been purchased from life insurance companies with the highest claims paying ability ratings as determined by outside ratings organizations. The Company has a contingent credit risk with respect to the failure of these life insurers which management have assessed as being immaterial. The Company believes it is not practical to determine the fair value of its financial guarantees or the maximum contingent potential payment of this guarantee on the structured settlements.

(Tabular amounts in thousands of dollars)

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

2009	827
2010	951
2011	985
2012	1,009
2013	1,042
Thereafter	3,643

(b) As at December 31, 2008, bonds and term deposits with an estimated fair value of $0.2 million (2007 – $0.2 million) were on deposit with regulatory authorities. Also, from time to time, the Company pledges assets to third parties to collateralize liabilities incurred under its policies of insurance or for the services provided by them to the company. At December 31, 2008, the amount of such pledged assets was $Nil (2007 – $Nil). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company's standard risk management controls.

18. Joint ventures:

The Company has a 75% ownership in a real estate joint venture with a related party which is commonly controlled and as such is accounted for as a joint venture. The following amounts represent the Company's proportionate interest:

	2008	2007
Current assets	1,927	1,176
Capital assets	29,664	31,374
Current liabilities	22	31
Investment Income	19	103
Cash flows resulting from operating activities	(1,761)	(2,208)
Cash flows resulting from investing activities	964	(7,395)

The capital assets include land of $3,756,000 (2007 – $3,756,000) and building of $25,091,000 (2007 – $27,618,000).

Schedule “D”

Unaudited pro forma consolidated statement of operations of The Westaim Corporation

THE WESTAIM CORPORATION

Unaudited Pro Forma Consolidated Statement of Operations
For the year ended December 31, 2009

THE WESTAIM CORPORATION
Pro Forma Consolidated Statement of Operations

For the year ended December 31, 2009
Unaudited
(thousands of dollars except share and per share data)

	The Westaim Corporation	Jevco Insurance Company	Kingsway General Insurance Company	Pro Forma Adjustments	Notes	Pro Forma Consolidated
PREMIUMS WRITTEN						
Direct	$ -	$ 184,982	$ 159,622	$ -		$ 344,604
Assumed	-	14,328	-	(14,328)	3(b)	-
	-	199,310	159,622	(14,328)		344,604
Ceded	-	27,543	111,962	(118,992)	3(a), 3(b)	20,513
NET PREMIUMS WRITTEN	-	171,767	47,660	104,664		324,091
REVENUE						
Net premiums earned	-	213,946	61,262	104,402	3(a), 3(b)	379,610
Investment income	832	18,278	2,643	9,310	3(a), 3(d)	31,063
Premium finance income	-	-	4,199	-		4,199
Net realized gain (loss) on sales of securities	193	4,355	(841)	-		3,707
	1,025	236,579	67,263	113,712		418,579
EXPENSES						
General and administrative	-	2,382	6,344	2,213	3(c), 3(d), 3(e), 3(g)	10,939
Corporate costs	5,180	-	-	-		5,180
Claims incurred	-	175,340	60,592	85,019	3(a), 3(b)	320,951
Commissions and premium taxes	-	51,588	43	17,058	3(a), 3(b), 3(d)	68,689
Management fees	-	22,604	22,300	(21,200)	3(c)	23,704
	5,180	251,914	89,279	83,090		429,463
OPERATING (LOSS) INCOME	(4,155)	(15,335)	(22,016)	30,622		(10,884)
FOREIGN EXCHANGE LOSS	(29)	-	-	-		(29)
GAIN ON BUSINESS ACQUISITION	-	-	-	23,720	3(f)	23,720
SITE RESTORATION PROVISION RECOVERY	805	-	-	-		805
GAIN ON ISSUANCE OF SHARES OF SUBSIDIARY	11	-	-	-		11
NON-CONTROLLING INTEREST	(2,364)	-	-	-		(2,364)
	(1,577)	-	-	23,720		22,143
(LOSS) INCOME FROM CONTINUING OPERATIONS, BEFORE INCOME TAXES	(5,732)	(15,335)	(22,016)	54,342		11,259
INCOME TAX EXPENSE (RECOVERY)	-	(4,096)	(7,779)	10,718	3(a), 3(b), 3(c), 3(e), 3(g)	(1,157)
(LOSS) INCOME FROM CONTINUING OPERATIONS	(5,732)	(11,239)	(14,237)	43,624		12,416
INCOME FROM DISCONTINUED OPERATIONS, NET OF INCOME TAXES	6,251	-	-	-		6,251
NET INCOME (LOSS)	$ 519	$ (11,239)	$ (14,237)	$ 43,624		$ 18,667
EARNINGS PER COMMON SHARE (Note 3(i) and 3(j))						
Continuing operations - basic and diluted						$ 0.02
Net income - basic and diluted						$ 0.03

See accompanying notes to the Unaudited Pro Forma Consolidated Statement of Operations

1. ACQUISITION OF JEVCO INSURANCE COMPANY

On March 29, 2010, The Westaim Corporation ("Westaim" or the "Company") purchased all of the issued and outstanding shares of Jevco Insurance Company ("Jevco") from Kingsway Financial Services Inc. (the "Acquisition"). On February 9, 2010 and February 19, 2010, the Company announced that it arranged financing of $275,000 (the "Financing") for the purpose of completing the Acquisition.

Jevco is a federal property and casualty insurance company continued under the *Insurance Companies Act* (Canada) ("ICA") and licensed to carry on property and casualty insurance business in all of the provinces and territories of Canada. Jevco specializes in providing insurance products covering non-standard auto, recreational vehicles, commercial auto, surety, property and liability.

Effective October 1, 2009, Jevco acquired the insurance operations of Kingsway General Insurance Company ("Kingsway General") through an Assumption Reinsurance agreement and also commuted significant reinsurance treaties with a related offshore reinsurance company. Both of these transactions have been treated as significant acquisitions in the pro forma consolidated statement of operations. Accordingly, the operations of both Kingsway General and Jevco are reflected in the pro forma consolidated statement of operations for the year ended December 31, 2009.

2. BASIS OF PRESENTATION

The accompanying unaudited pro forma consolidated statement of operations of Westaim has been prepared by management of the Company to give effect to the purchase of Jevco. A pro forma consolidated balance sheet has not been presented as the Acquisition was accounted for in Westaim's unaudited interim consolidated financial statements as at and for the three month period ended March 31, 2010 which has been filed on SEDAR and can be obtained at www.sedar.com. In management's opinion, the pro forma consolidated statement of operations includes all material adjustments necessary for a fair presentation in accordance with Canadian generally accepted accounting principles ("GAAP").

The pro forma consolidated statement of operations for the year ended December 31, 2009 has been prepared from information derived from the audited consolidated financial statements of Westaim for the year ended December 31, 2009, the audited financial statements of Jevco for the year ended December 31, 2009, the unaudited interim financial statements of Kingsway General for the nine months ended September 30, 2009 and the pro forma assumptions and adjustments, as set out in Note 3.

2. BASIS OF PRESENTATION (continued)

The pro forma consolidated statement of operations is not necessarily indicative either of the results that actually would have occurred if the events reflected herein had taken place on the dates indicated or of the results that may be obtained in the future. In addition, the pro forma consolidated statement of operations does not give effect to any transactions that are not considered significant by management and do not meet the significance test rules as defined by various securities regulators.

In preparing the pro forma consolidated statement of operations, no adjustments have been made to reflect operating cost or general and administrative expense savings, if any, that may result from the operations of the combined companies, other than those relating to an estimate of former parent company costs and mark-ups embedded in management agreements.

Accounting policies used in the preparation of the pro forma consolidated statement of operations are in accordance with those disclosed in Westaim's audited consolidated financial statements as at and for the year ended December 31, 2009 and those disclosed in Jevco's audited financial statements as at and for the year ended December 31, 2009.

It is the recommendation of management that this financial information should be read in conjunction with Westaim's audited consolidated financial statements as at and for the year ended December 31, 2009, the audited financial statements of Jevco as at and for the year ended December 31, 2009 and Westaim's unaudited interim consolidated financial statements as at and for the three month period ended March 31, 2010.

3. PRO FORMA CONSOLIDATED FINANCIAL STATEMENT OF OPERATIONS, TRANSACTIONS AND ASSUMPTIONS FOR THE YEAR ENDED DECEMBER 31, 2009

The pro forma consolidated statement of operations for the year ended December 31, 2009 has been prepared assuming that the Acquisition was completed on January 1, 2009, using the following assumptions:

a) As more fully discussed in Note 3 of the December 31, 2009 Jevco audited financial statements, on October 1, 2009, Jevco and Kingsway General commuted their reinsurance treaties with a related offshore reinsurance company. The commutations have been treated as a significant acquisition for purposes of the pro forma consolidated statement of operations. All reinsurance and associated investment transactions with the offshore reinsurance company related to the commuted contracts have been eliminated as pro forma adjustments in the pro forma consolidated statement of operations for the year ended December 31, 2009.

   As a result, ceded written premiums of $67,320 were eliminated, net premiums earned were increased by $104,235, claims incurred were increased by $90,742, commissions and premium taxes were increased by $21,216, investment income was increased by $8,160 and income taxes were increased by $153.

3. PRO FORMA CONSOLIDATED FINANCIAL STATEMENT OF OPERATIONS, TRANSACTIONS AND ASSUMPTIONS FOR THE YEAR ENDED DECEMBER 31, 2009 (continued)

b) As more fully discussed above and in Note 3 of the December 31, 2009 Jevco audited financial statements, effective October 1, 2009, but subsequent to the commutations described in Note 3(a) above, Jevco entered into an Assumption Reinsurance agreement with Kingsway General whereby Jevco assumed all the policy related assets and liabilities and the supporting invested assets of Kingsway General. On account of this significant transaction, Kingsway General's operations for the nine months ended September 30, 2009 are included as a separate column in the pro forma consolidated statement of operations. Intercompany reinsurance transactions among Jevco, Kingsway General and a former related insurance company during the year ended December 31, 2009 have been eliminated.

   As a result, assumed written premiums of $14,328 were eliminated as were ceded written premiums of $51,672. Net premiums earned were increased by $167, claims incurred were reduced by $5,723, commissions and premium taxes were reduced by $4,721 and income taxes were increased by $3,715.

c) Jevco and Kingsway General had management agreements with their parent company whereby the companies paid a management fee equal to 115% of the direct costs and expenses incurred or paid by the parent in the provision of goods and services, facilities, supplies, equipment, premises and repairs in accordance with the said agreements. In addition, certain of the expenses related to these agreements have been determined by management to be duplicative or unrelated to the on-going operations of Jevco. These additional costs and the 15% profit margin charged on all management fees by the parent company have been eliminated in the preparation of the pro forma consolidated statement of operations for the year ended December 31, 2009.

   As a result, management fees were reduced by $21,200, general and administrative expenses were increased by $134 and income taxes were increased by $7,373.

d) Investment income was increased by $1,150 to reclassify expenses on Jevco's own use property to general and administrative expenses. In addition, general and administrative expenses were then reduced by $563 in order to properly reclassify this amount to commissions and premium taxes.

e) Increase in depreciation of $50 and decrease in income taxes of $18 related to the increase in fair value of the buildings acquired of $1,262 amortized using 4% declining balance.

f) Recognition of gain on acquisition of $23,720, which is non-taxable, related primarily to the net assets of Jevco being acquired at a 5.5% discount to its net book value at December 31, 2009. In accordance with Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1582, *Business Combinations* ("Section 1582"), a bargain purchase is accounted for as a gain on acquisition.

(thousands of dollars, except share and per share data)

3. PRO FORMA CONSOLIDATED FINANCIAL STATEMENT OF OPERATIONS, TRANSACTIONS AND ASSUMPTIONS FOR THE YEAR ENDED DECEMBER 31, 2009 (continued)

g) Transaction costs related to the Acquisition were approximately $1,442 and have been expensed and income taxes have been reduced by $505. Westaim has adopted CICA Handbook Section 1582, which requires transaction costs incurred in conjunction with a business combination to be expensed.

h) Adjustments to the provision for income taxes to reflect the changes to taxable income subsequent to the Acquisition, assuming an effective tax rate of approximately 35%.

i) The basic earnings per Westaim share has been based on the following weighted average number of Westaim shares adjusted as follows:

Basic weighted average number of Westaim shares outstanding for the year ended December 31, 2009	94,219,579
Adjustment for subscription receipts issued and converted to Shares	550,000,000
	644,219,579

j) The diluted earnings per Westaim share has been based on the following weighted average number of Westaim shares adjusted as follows:

Diluted weighted average number of Westaim shares outstanding for the year ended December 31, 2009	94,486,779
Adjustment for subscription receipts issued and converted to shares	550,000,000
Effect of dilutive securities	
Warrants issued in conjunction with the Financing	-
Stock options	-
	644,486,779